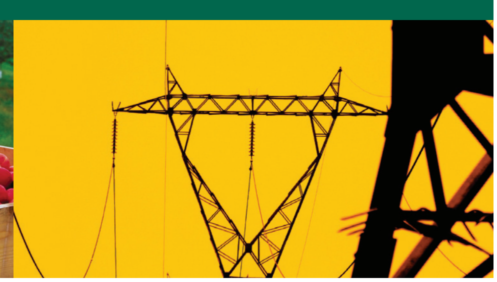
Washington State Department of
Labor & Industries

State of Washington Industrial Insurance Fund

Statutory Financial Information Report

For the Fiscal Years Ended June 30, 2012 and 2011



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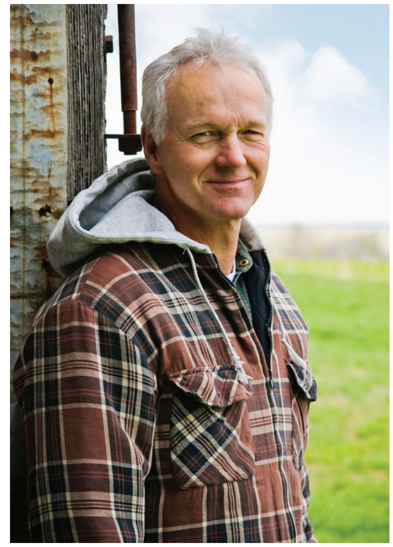

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Washington State Office of Financial Management
Washington State Investment Board

Washington State Department of
Labor & Industries

Keep Washington Safe and Working

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Introductory Section

Washington State Department of
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Keep Washington Safe and Working

STATE OF WASHINGTON
DEPARTMENT OF LABOR AND INDUSTRIES

December 7, 2012

The Honorable Christine Gregoire, Governor
Honorable Members of the Legislature
Director of Office of Financial Management
Washington State Citizens
Olympia, Washington 98504

RE: Statutory Financial Information Report (SSAP)

The Revised Code of Washington 51.44.115 requires the Department of Labor & Industries (L&I) to publish a Statutory Financial Information Report for the Industrial Insurance Fund (State Fund) in conformity with statutory accounting practices and principles promulgated by the National Association of Insurance Commissioners within six months of the close of each fiscal year. This report is published to fulfill that requirement for the fiscal year ended June 30, 2012.

L&I is fully responsible for the completeness and reliability of the information contained in this report, based upon a comprehensive framework of internal controls established for this purpose. Because the cost of internal controls should not exceed anticipated benefits, the objective is to provide reasonable, rather than absolute, assurance that the financial statements are free of any material misstatements.

The independent certified public accounting firm, Eide Bailly, LLP, has issued an unqualified ("clean") opinion on the Statutory Financial Information Report for the fiscal years ended June 30, 2012 and 2011. The independent auditor's report is located at the front of the financial section of this report.

Management's Discussion and Analysis (MD&A) immediately follows the independent auditor's report and provides a narrative introduction, overview, and analysis of the consolidated statutory financial statements. The MD&A complements the information provided in this letter of transmittal and should be read together with it.

Following the MD&A are the consolidated financial statements and notes to the financial statements. The required schedules and an independent actuarial opinion complete the Statutory Financial Information Report.

PROFILE OF THE STATE FUND

The workers' compensation system has existed in Washington State for 101 years. Washington was one of the first states to enact workers' compensation laws. Our state's Workmen's Compensation Act, established on July 28, 1911, was designed to protect workers and employers from injustice and financial hardship arising from work-related injuries in extremely hazardous work. In 1923, Washington became one of only two states where workers pay a portion of the insurance premiums.

The Industrial Insurance Fund (also known as the State Fund) covers 166,000 employers and approximately 2.42 million workers statewide. Total premiums assessed in Fiscal Year 2012, including both the employer and worker portions, in the State Fund were $1.65 billion. Approximately 39,000 claims are active in any given month, of which about 20,000 are receiving time-loss benefits, many of which involve long-term disability and complex medical issues. Over 84,000 claims were accepted in Fiscal Year 2012; about 80 percent of the accepted claims were medical only and received no compensation for time off work. In the same year, retraining plans were completed by 595 injured workers who were not able to return to their occupations after injury.

The Industrial Insurance Fund (State Fund) is part of the Workers' Compensation Fund and is made up of the Accident, Medical Aid, and Pension Reserve Accounts. The activities within the Industrial Insurance Fund are financed and operated in a manner similar to private business entities. The cost of providing medical, time-loss, and disability benefit payments to qualifying individuals sustaining work-related injuries and illnesses, as well as Stay at Work reimbursements and Structured Settlement agreements, is financed through premiums collected from employers and workers. L&I prepares a Statutory Financial Information Report for the Washington State Industrial Insurance Fund of the Workers' Compensation Fund annually, based on a fiscal year beginning July 1 and ending June 30.

During the 2011 Legislative Session, the Legislature passed historic changes to the workers' compensation system, including creating the Stay at Work and Structured Settlement Programs. Both of these programs were implemented by L&I during Fiscal Year 2012 and have the potential to impact the choices for injured workers and the rates paid by employers. Also, a significant effort is underway to create a Medical Provider Network, which is expected to improve medical treatment of injured workers.

The Stay at Work Program provides a financial incentive for employers to bring their injured workers quickly and safely back to light-duty or transitional work. Eligible employers can be reimbursed up to 50 percent of the base wages paid to the injured workers for up to 66 work days, as well as $1,000 in training materials, $2,500 in tools, and up to $400 in clothing for each claim. As of June 30, 2012, L&I has issued $3.9 million in reimbursements to 858 employers and helped 2,014 injured workers remain on the job since the program was signed into law on June 15, 2011. These numbers continue to increase. The program is projected to save $32 million annually by keeping workers on the job and reducing the chance of long-term disability.

Structured settlement agreements provide a new option for resolving the non-medical portion of industrial insurance claims for injured workers over the age of 55 (dropping to 53 in 2015 and 50 in 2016) who meet certain other requirements. This is a voluntary program in which those who qualify can settle their claims and receive a financial settlement on a payment schedule. Since January 2012, L&I has received 283 State Fund structured settlement applications.

ACKNOWLEDGEMENTS

As in the work and service we provide every day, this Statutory Financial Information Report represents our commitment to maintain excellence in financial reporting, and the financial statements are in conformance with the highest standards of financial accountability.

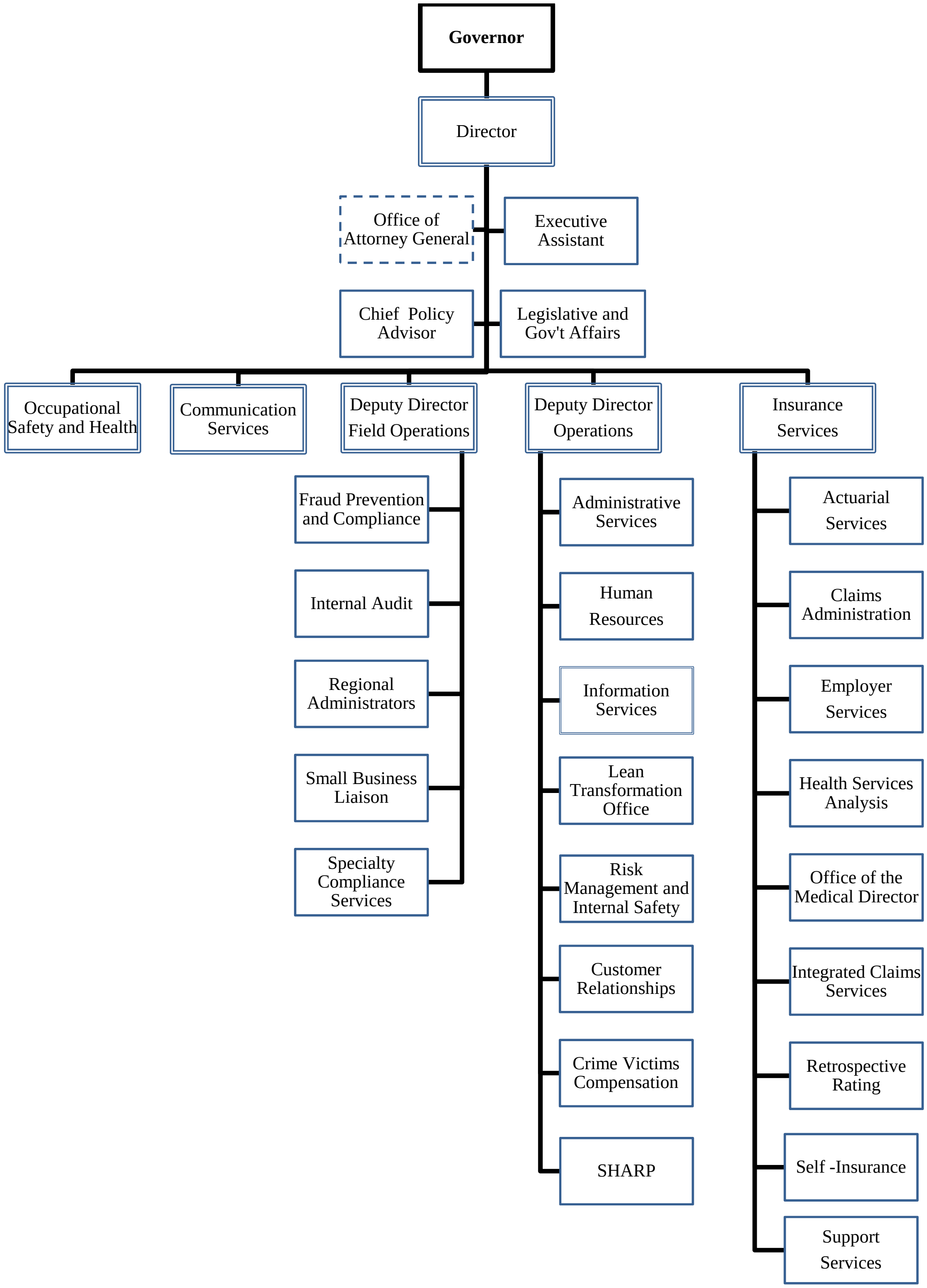
The preparation of this report could not have been accomplished without the professionalism and dedication demonstrated by the financial and management personnel of L&I, the Washington State Office of Financial Management, and the Washington State Investment Board.

Sincerely,

Judy Schurke Director	Carole Washburn Deputy Director for Operations

Washington State Department of
Labor & Industries

Organization Chart
2011 – 2012



June 30, 2012

Financial Section

Washington State Department of
Labor & Industries

Keep Washington Safe and Working

Independent Auditor's Report

Ms. Judy Schurke Director
Washington State Department of Labor & Industries
Industrial Insurance Fund
P.O. Box 44001
Olympia, WA 98504-4001

We have audited the accompanying Consolidated Statutory Statement of Admitted Assets, Liabilities and Contingency Reserve of Washington State Department of Labor & Industries Industrial Insurance Fund (Fund) as of June 30, 2012 and 2011, and the related Consolidated Statutory Statements of Operations and Changes in Contingency Reserve, and Cash Flows for the years then ended. The consolidated statutory-based financial statements for the year ended June 30, 2011 have been summarized to present the consolidated totals, for comparative purposes. These statutory-basis financial statements (referred to as the financial statements) are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we do not express such an opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements and assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described more fully in Note 1 to the financial statements, the Fund's prepared these financial statements using accounting practices prescribed or permitted by the Insurance Division of the State of Washington, which practices differ from accounting principles generally accepted in the United States of America. The effects on the financial statements of the variances between the statutory basis of accounting and accounting principles generally accepted in the United States, although not reasonably determinable, are presumed to be material.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial positions of Washington State Department of Labor & Industries Industrial Insurance Fund as of June 30, 2012 and 2011 or the results of its operations or its cash flows for the years then ended.

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In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and contingency reserve of Washington State Department of Labor & Industries Industrial Insurance Fund as of June 30, 2012 and 2011 and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in Note 1.

Our audits were conducted for the purpose of forming an opinion on the basic consolidated statutory-basis financial statements taken as a whole. The accompanying supplementary information included on the *Schedule of Claims Development Information Basic Plan*, and the *Schedule of Funding Progress for Other Postemployment Benefits* on pages 74 through 75 are not a required part of the basic consolidated statutory-basis financial statements. The accompanying supplementary information included in the *Supplemental Schedule of Investment Risk Interrogatories* and the *Summary Investment Schedule* on pages 76 through 79 are required to be presented to comply with the National Association of Insurance Commissioners' Annual Statement Instructions and the National Association of Insurance Commissioners' Accounting Practices and Procedures Manual and are not a required part of the basic statutory-basis consolidated financial statements. Such information included in the four schedules referred to above is the responsibility of management, is presented for purposes of additional analysis and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other procedures in accordance with the auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic consolidated statutory-basis financial statements taken as a whole.

Our audit was conducted for the purpose of forming an opinion on the basic consolidated statutory-basis financial statements taken as a whole. The information contained in the *Introductory Section*, *Management Discussion and Analysis* and the *Statement of Actuarial Opinion* sections, as listed in the accompanying table of contents, are presented for purposes of additional analysis and are not a required part of the basic statutory financial statements. Such information contained in the sections referred to in this paragraph are the responsibility of management and have not been subjected to the auditing procedures applied in the audit of the basic consolidated statutory-basis financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Eide Bailly LLP

Fargo, North Dakota
December 4, 2012

Management's Discussion and Analysis

The state of Washington's Department of Labor & Industries (L&I) administers the state Workers' Compensation Fund, including the Industrial Insurance Fund (also known as the State Fund).

This section of the state of Washington Industrial Insurance Fund's Statutory Financial Information Report presents management's discussion and analysis of the financial performance of the Industrial Insurance Fund for the fiscal years ended June 30, 2012 and 2011. This discussion should be read in conjunction with the accompanying consolidated statutory financial statements and notes to the consolidated statutory financial statements. The consolidated statutory financial statements, notes to the consolidated statutory financial statements, and this discussion are the responsibility of the Industrial Insurance Fund's management.

History and Information that Makes the State of Washington's Industrial Insurance Fund Unique

The state of Washington's Workmen's Compensation Act established the industrial insurance system in 1911, covering only extremely hazardous work. Washington's workers' compensation insurance was provided solely through the State Fund until 1971, when the system underwent a major overhaul. In 1971, the Legislature expanded the scope of coverage to virtually all workers and created an option for qualified employers to self-insure, thus paying the cost of claims for their injured workers from their own funds and also assuming responsibility for their own claims administration.

Washington State, through Title 51 of the Revised Code of Washington (RCW), requires all employers, unless exempted, to secure coverage for job-related injuries and illnesses either by paying insurance premiums to the Industrial Insurance Fund or by self-insuring. Direct private insurance is not authorized, although self-insurers are permitted to reinsure up to 80 percent of their obligations.

Under statute RCW 51.16.035, L&I is required to have the lowest possible rates while maintaining solvency of the system. It is also required to design a premium rating system that limits rate fluctuations, follows recognized insurance principles, and stimulates and encourages accident prevention.

In Washington, premiums are based on the workers' exposure to risk (hours on the job), which employers and workers agreed to in the 1930s. Also, Washington requires both the employers and workers to contribute to the cost of premiums.

Workplace Injuries

Washington's workers' compensation system provides insurance for about 2.42 million employees working for 166,000 employers. Men accounted for 67 percent of injured workers, and 46 percent of all injuries were to workers from 30 to 50 years of age. The most common injuries were to muscles, tendons, ligaments, and back joints, including spine and spinal cord. Thirty-five fatal pensions were awarded in Fiscal Year 2012. Below is a comparison of select Industrial Insurance Fund statistics.

Statistics at a Glance

		Fiscal Year 2012		Fiscal Year 2011
Employers insured		166,000		163,000
Workers covered		2,420,000		2,360,000
Hours reported		3,183,000,000		3,100,000,000
Premiums assessed (employers' portion)	$	1,358,000,000	$	1,210,000,000
Premiums assessed (workers' portion)	$	290,000,000	$	301,000,000
Benefits incurred	$	1,957,245,000	$	1,601,225,000
Number of claims filed		101,524		100,690
Total days paid for lost work		7,850,982		8,099,675

Note: The data above are a snapshot as of the first week of October.

Using the Statutory Financial Statements

The accompanying consolidated statutory financial statements include the Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve; Consolidated Statutory Statement of Operations and Changes in Contingency Reserve; and Consolidated Statutory Statement of Cash Flows. These financial statements have been prepared in conformity with the Statements of Statutory Accounting Principles (SSAP), as promulgated by the National Association of Insurance Commissioners, whereby the main purpose of SSAP-based information is to determine solvency. Solvency is defined as the availability of the Industrial Insurance Fund’s admitted assets to satisfy its obligations to injured workers and beneficiaries. The notes to the consolidated statutory financial statements provide additional information that is essential to a full understanding of the data provided in the consolidated statutory financial statements.

The accompanying consolidated statutory financial statements report the financial position and results of operations for three out of the seven Workers’ Compensation Fund accounts: the Accident, Medical Aid, and Pension Reserve Accounts. These three accounts represent the Workers’ Compensation Fund Basic Plan, also known as the Industrial Insurance Fund or State Fund. The Industrial Insurance Fund is accounted for as an enterprise fund of the state of Washington and reports business activities under the accrual basis of accounting, much like a private business enterprise.

Overview of the Financial Statements

This discussion and analysis serves as an introduction to the Industrial Insurance Fund's financial statements, which consist of the following components:

The Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve provides information about the Fund's admitted assets and liabilities and reflects the contingency reserve as of June 30, 2012 and 2011. The Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve can be found on page 23 of this report.

The Consolidated Statutory Statement of Operations and Changes in Contingency Reserve reflects revenues and expenses for Fiscal Years 2012 and 2011. The Consolidated Statutory Statement of Operations and Changes in Contingency Reserve can be found on page 24 of this report.

The Consolidated Statutory Statement of Cash Flows reflects cash collections and cash payments to arrive at the net increase or decrease in cash during Fiscal Years 2012 and 2011. The Consolidated Statutory Statement of Cash Flows can be found on page 25 of this report.

The Notes to the Consolidated Statutory Financial Statements are an integral part of the financial statements and are essential to a full understanding of the Industrial Insurance Fund's financial position and results of operations presented in the financial statements. The Notes to the Consolidated Statutory Financial Statements can be found on page 27 of this report.

Elimination for Consolidated Financial Statements

It is important to the readers of the Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve that we include details of each account, report the true contingency reserve balance, and show compliance with the statutory Pension Reserve Account experting requirement. In order to arrive at an accurate consolidated Industrial Insurance Fund balance, this elimination is made up of Pension Reserve Account experting, which requires the Accident Account to transfer $42,718,000 to the Pension Reserve Account.

Financial Highlights

Condensed Financial Snapshot
(dollars in millions)

	As of and For the Fiscal Year Ended June 30, 2012	As of and For the Fiscal Year Ended June 30, 2011	$ Change	% Change
Total Admitted Assets	$ 12,512	$ 14,455	$ (1,943)	(13.44%)
Total Liabilities	11,931	13,675	(1,744)	(12.75%)
Total Revenues Earned	2,647	2,124	523	24.62%
Total Expenses Incurred	2,283	1,915	368	19.22%
Total Contingency Reserve	$ 580	$ 779	$ (199)	(25.55%)

Financial Position

The Industrial Insurance Fund's financial position at June 30, 2012 and 2011 was as follows:

Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve
As of June 30, 2012 and 2011
(in thousands)

		June 30, 2012		June 30, 2011
Admitted Assets				
Fixed income investments	$	8,625,928	$	8,357,821
Treasury inflation-protected securities		1,619,787		1,584,817
Equities investments		1,580,216		1,639,241
Short-term investments		82,211		114,550
Unsettled trade receivables (payables)		7		(24,841)
Total Investments		11,908,149		11,671,588
Securities lending collateral		-		2,217,078
Interest receivable		109,617		108,936
Cash and cash equivalents		6,970		7,856
Premiums receivable, net		432,484		413,015
Other assets		54,566		36,086
Total Admitted Assets	$	12,511,786	$	14,454,559
Liabilities and Contingency Reserve				
Benefit liabilities	$	11,202,955	$	10,793,048
Claims administration liabilities		535,975		495,262
Retrospective rating adjustments		121,690		91,159
OPEB liabilities		29,006		23,330
Other liabilities		41,790		55,313
Collateral from securities lending activities		-		2,217,078
Total Liabilities		11,931,416		13,675,190
Contingency reserve		580,370		779,369
Total Liabilities and Contingency Reserve	$	12,511,786	$	14,454,559

Note: See detail on comprehensive Consolidated Statutory Financial Statements.

Total admitted assets of $12.5 billion decreased by $1.9 billion, or 13.4 percent, as compared to the end of Fiscal Year 2011, mainly due to a decrease in securities lending collateral of $2.2 billion, offset by a $236.6 million increase in total investments. Both assets and liabilities from securities lending activities decreased by $2.2 billion as compared to the last fiscal year-end. The Washington State Investment Board (WSIB) changed the custodian bank acting as agent in securities lending transactions from JPMorgan to State Street, effective July 1, 2012. In anticipation of the custodian bank conversion, the WSIB recalled all securities on loan. Thus, there were no assets on loan and no collateral held related to securities lending transactions at June 30, 2012. Additional information on security lending collateral is included in Note 8, Sale, Transfer and Servicing of Financial Assets and Extinguishments of Liabilities, of this report. Total investments grew by $236.6 million compared to the prior year-end due to prudent management by the WSIB despite continued slow economic growth. The most significant change in the investment balance is from the increase of $268.1 million in fixed income since June 30, 2011, which was due to favorable market conditions.

Total benefit liabilities of $11.2 billion increased by $409.9 million during Fiscal Year 2012, mainly due to development on prior accident year liabilities including discount accretion, other development, and change in the non-tabular discount rate. New liabilities slightly decreased from the prior year as a result of a decrease in claim frequency, offset by an increase in severity. Non-tabular discount rates were changed in December 2011 from 2.5 percent to 2.0 percent. This change resulted in an increase of $81.3 million in benefit liabilities. Detailed changes in the benefit liabilities are explained in Note 9, Changes in Benefit and Claims Administration Liabilities, of this report.

The Industrial Insurance Fund’s changes in benefit liabilities as of June 30, 2012 and 2011 are shown below:

Benefit Liabilities
(in thousands)

	June 30, 2012	June 30, 2011
Benefit liabilities, beginning	$ 10,793,048	$ 10,748,429
New liabilities incurred, current year	1,388,204	1,419,262
Development on prior years		
Discount accretion	379,617	372,581
Other development on prior liabilities	108,077	(236,573)
Change in discount rate	81,346	-
Claim payments	(1,547,337)	(1,556,606)
Establishing self-insurance second injury pension awards	-	45,955
Change in benefit liabilities	409,907	44,619
Benefit liabilities, ending	$ 11,202,955	$ 10,793,048

During Fiscal Year 2012, total liabilities, other than benefit liabilities and securities lending collateral, increased $63.4 million, or 9.5 percent, due to the following:

- Claims administration liabilities are calculated as a percentage of reserves, which increased from the prior fiscal year, resulting in a $40.7 million increase in claims administration liabilities.

- Liabilities for retrospective rating adjustments is an estimate provided by the actuaries, and it represents the net ultimate premium refund for retrospectively-rated policies from October 1, 2009, through March 31, 2011. Retrospective rating adjustments increased by $30.5 million, largely due to the observed recent improvement in the relative performance of retro-participating firms compared to non-participating firms.

- Other accrued liabilities decreased by $13.8 million, largely due to a decrease in the amount payable to the Second Injury Account as a result of evaluating the assets and liabilities of the Pension Reserve Account.

- Other postemployment benefit (OPEB) liabilities increased by $5.7 million to account for the additional liability accrued in Fiscal Year 2012. For additional details on OPEB accruals, please refer to Note 5.D., Other Postemployment Benefits, of this report.

Results of Operations

Industrial Insurance Fund operating results and certain key financial ratios are presented in the following table:

Consolidated Statutory Statement of Operations and Changes in Contingency Reserve
For the Fiscal Years Ended June 30, 2012 and 2011
(dollars in thousands)

	June 30, 2012	June 30, 2011
Net premiums earned	$ 1,463,393	$ 1,429,530
Assumed premiums earned	78,116	59,360
Total net premiums earned	1,541,509	1,488,890
Net investment income earned	481,892	491,654
Net investment realized gains	547,771	68,768
Other income	75,793	74,347
Total Revenue Earned	2,646,965	2,123,659
Net benefits (losses) incurred	1,957,245	1,601,225
Claims administration expenses (LAE) incurred	184,878	159,641
Premium administration expenses incurred	33,980	44,612
Other administration expenses incurred	37,182	39,767
Self-insured administration expenses incurred	24,175	23,875
Non-insurance administration expenses incurred	46,034	46,236
Total Administration Expenses Incurred	326,249	314,131
Total Expenses Incurred	2,283,494	1,915,356
Net Transfers In (Out)	-	-
Net Income (Loss)	363,471	208,303
Other changes in contingency reserve	(562,470)	389,856
Changes in contingency reserve, net	(198,999)	598,159
Beginning contingency reserve, July 1	779,369	181,210
Ending Contingency Reserve, June 30	$ 580,370	$ 779,369
Loss ratio	127.0%	107.5%
Loss adjustment expense (LAE) ratio	12.0%	10.7%
Loss and LAE Ratio	139.0%	118.2%
Underwriting and other expense ratio	4.3%	5.4%
Combined Ratio	143.3%	123.6%
Less: Net investment income ratio	31.3%	33.0%
Operating Ratio	112.0%	90.6%

Note: See detail on comprehensive Consolidated Statutory Financial Statements.

The Industrial Insurance Fund’s contingency reserve decreased by $199.0 million during Fiscal Year 2012, ending with a balance of $580.4 million. The change in the contingency reserve is largely due to adverse development in prior liabilities, changes in non-tabular account discount rates, and unexpected investment results.

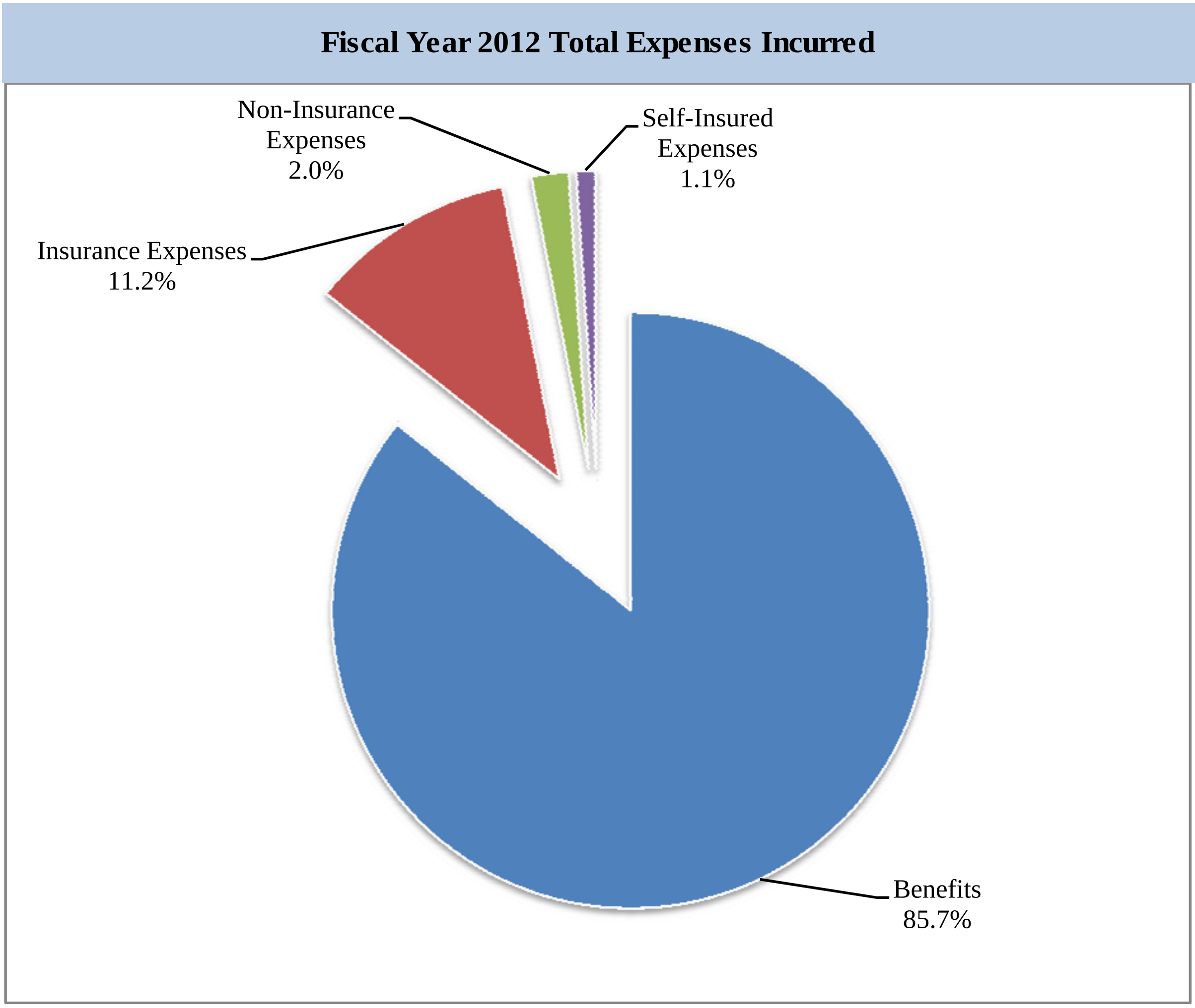
Net premiums earned of $1.5 billion during Fiscal Year 2012 increased by $33.9 million, or 2.4 percent, from Fiscal Year 2011. This increase is primarily due to an increase in the number of hours reported by employers and change in the premium rates. In Fiscal Year 2011, employers reported 3.100 billion hours worked; this figure has increased to 3.183 billion hours for Fiscal Year 2012.

Net investment income earned decreased during Fiscal Year 2012 by $9.8 million. This decrease is mainly due to $10.2 million less in dividends. State Street Global Advisor (SSgA), the investment manager of L&I’s international equities portfolio, has changed the way they are managing dividend transactions. The common trust funds (CTFs) are no longer distributing income as of March 31, 2012. Where SSgA had previously reported a Dividend Reinvestment transaction at the end of each quarter with a corresponding drop in the Net Asset Value (NAV) in equities, the income will now remain in the NAV of the CTF. This changed the “net investment income earned” line item by showing less income earned on the Statement of Operations and Changes in Contingency Reserve and more equities unrealized gains/losses, the line item that reflected the reinvestment. This change, however, has no impact on the overall returns of L&I’s equity portfolio, as investment income, realized gains/losses, and unrealized gains/losses must be looked at collectively in relation to the total NAV of equity securities.

Benefits incurred during Fiscal Year 2012 totaled $2.0 billion, an increase of $356.0 million, or 22.2 percent, from Fiscal Year 2011. Benefits incurred is made up of net benefits paid plus the change in benefit liabilities. Although benefits paid decreased by 0.6 percent, net benefits incurred increased due to the change in the benefit liabilities. The overall increase in benefit liabilities was 3.8 percent compared to June 30, 2011.

Total administration expenses incurred increased $12.1 million, mainly as a result of increased claims administration expenses incurred. The increase in claims administration expenses is primarily due to the change in claims administration liabilities, offset by a decrease in other administration expenses incurred.

The following chart shows the ratio of benefit, insurance, non-insurance, and self-insured expenses incurred for Fiscal Year 2012:



The following ratios are recognized industry measures used to compare one insurance company to another. The ratios are expressed as a percentage of total net premiums earned.

- The benefit (loss) and loss adjustment expense (LAE) ratio represents the total costs for processing claims and benefits as a percentage of total net premiums earned. Although our LAE ratio is consistently lower than the industry average, our loss ratio is higher than the industry average. There are many factors that impact loss and LAE ratios, including Legislative decisions, claim frequency, severity, and exposure. These ratios have been impacted by historic changes to Washington's workers' compensation system passed by the Legislature during the 2011 session, continued slow economic recovery, and the change in the benefit liabilities discount rates.

- The combined ratio expresses total costs, including incurred expenses for benefits and administration, less other income (which includes self-insured administration expense assessments), as a percentage of total net premiums earned. When the net costs exceed net premium revenues, the combined ratio exceeds 100 percent. This is expected, because income earned on investments supplements premium revenues to cover costs, so premium rates are set accordingly to arrive at anticipated breakeven.

- The operating ratio reflects the combined ratio less the net investment income ratio and is another industry measure of overall financial performance. Ratios above 100 percent indicate that expenses are greater than premiums, net investment income earned, and other income. Insurance companies are motivated to make profits and, therefore, work towards an operating ratio below 100 percent; however, the State Fund is operated as a part of state government, and its goal is to breakeven. An operating ratio greater than 100 percent decreases the contingency reserve balance.

- The combined ratio of 143.3 percent and operating ratio of 112.0 percent increased for Fiscal Year 2012 from the previous year ratios of 123.6 and 90.6 percent, respectively. Increased benefit and claims administration costs and lower dividend income impacted these ratios. However, the Underwriting and Other Expense Ratio of 4.3 percent decreased from 5.4 percent in the prior year and remains consistently low compared to the industry average.

Cash Flows and Liquidity

Cash Flows - The primary sources of cash were from premiums collected and investment income. The primary uses of cash were for payment of benefits, administration expenses, and purchases of investments.

Cash flows of the Industrial Insurance Fund are summarized as follows:

Consolidated Statutory Statement of Cash Flows
For the Fiscal Years Ended June 30, 2012 and 2011
(in thousands)

	June 30, 2012	June 30, 2011
Operations		
Net premiums collected	$ 1,474,455	$ 1,344,190
Other reimbursements and income	110,932	132,056
Net benefits paid	(1,547,338)	(1,556,606)
Insurance expenses paid	(213,508)	(216,808)
Self-insured expenses paid	(23,319)	(23,398)
Non-insurance expenses paid	(44,138)	(44,055)
Cash used in operations	(242,916)	(364,621)
Investment Activities		
Investment income	484,865	488,857
Net realized gains	547,771	68,768
Purchases, net	(786,782)	(186,939)
Investment management expenses	(3,824)	(4,052)
Cash provided by investment activities	242,030	366,634
Change in Cash		
Net increase (decrease) in cash	$ (886)	$ 2,013

Note: See detail on comprehensive Consolidated Statutory Financial Statements.

During Fiscal Year 2012, cash decreased by $0.9 million, as opposed to an increase in cash of $2 million during Fiscal Year 2011. This is primarily a result of an increase in net premiums collected of $130.3 million, an increase in investment income and net realized gains of $475.0 million, and a decrease in net benefits paid of $9.3 million, offset by an increase in investment purchases of $599.8 million.

Liquidity - The Industrial Insurance Fund's operations require sufficient liquidity to meet both short-term and long-term requirements. Resources to ensure short-term liquidity come from two basic elements:

- L&I may increase rates in order to increase its contingency reserve, resulting in positive cash flow.

- Premiums are paid to L&I every three months.

The Industrial Insurance Fund has generally met its operating requirements by maintaining appropriate levels of liquidity in its investment portfolio and through utilization of positive cash flow. The Industrial Insurance Fund is able to match projected cash inflows from premiums and investment income from this portfolio with projected cash outflows for payment of benefits.

Future Plan

Our agency mission is to "Keep Washington Safe and Working," with a strategic objective to keep premium rates fair and stable for our services while maintaining the solvency of the Industrial Insurance Fund. In order to meet these objectives, we will manage investments carefully to preserve income, remain innovative in developing new strategies to deliver benefits and services of the Workers' Compensation Fund, and continue to work with our stakeholders to ensure that the needs of the business community and workforce are met.

Requests for Information

This report is designed to provide a general overview of the Industrial Insurance Fund and to illustrate the Fund's financial position and results of operations to interested parties. If you have any questions about this report or need additional financial information, please contact the Chief Accounting Officer at the Department of Labor & Industries, P.O. Box 44833, Olympia, Washington 98504-4833.

The Industrial Insurance Fund Statutory Financial Information Report is also available at the Department of Labor & Industries' website at:
http://www.lni.wa.gov/ClaimsIns/Insurance/Learn/StateFund/Reports.

In accordance with the Revised Code of Washington (RCW) 51.44.115, the Department of Labor & Industries also publishes a Comprehensive Annual Financial Report (CAFR) for the Workers' Compensation Fund. This report is prepared in compliance with generally accepted accounting principles (GAAP) and is also available at the website listed above.

Consolidated Statutory Financial Statements

Washington State Department of
Labor & Industries

Keep Washington Safe and Working

Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve
As of June 30, 2012 and 2011
(rounded to the nearest $1,000)

	Accident Account	Medical Aid Account	Pension Reserve Account	Elimination for Consolidated Statements	Total June 30, 2012	Total June 30, 2011
Admitted Assets						
Cash and Investments						
Investments, net						
Fixed income	$ 3,383,109,000	$ 2,562,377,000	$ 2,680,442,000	$ -	$ 8,625,928,000	$ 8,357,821,000
Treasury inflation-protected securities	457,406,000	854,278,000	308,103,000	-	1,619,787,000	1,584,817,000
Equities	470,795,000	734,925,000	374,496,000	-	1,580,216,000	1,639,241,000
Short term	31,202,000	6,728,000	44,281,000	-	82,211,000	114,550,000
Unsettled trade receivables	3,000	3,000	1,000	-	7,000	(24,841,000)
Total investments	4,342,515,000	4,158,311,000	3,407,323,000	-	11,908,149,000	11,671,588,000
Securities lending collateral	-	-	-	-	-	2,217,078,000
Interest receivable	41,341,000	34,427,000	33,849,000	-	109,617,000	108,936,000
Cash and cash equivalents	3,534,000	2,128,000	1,308,000	-	6,970,000	7,856,000
Total Cash and Investments	4,387,390,000	4,194,866,000	3,442,480,000	-	12,024,736,000	14,005,458,000
Other Assets						
Premiums receivable, net, incl. earned but unbilled	277,213,000	155,271,000	-	-	432,484,000	413,015,000
Real estate and improvements						
(less $14,875,000 encumbrances)	13,899,000	13,899,000	-	-	27,798,000	25,967,000
Self insurance receivables, net	3,340,000	3,257,000	5,495,000	-	12,092,000	8,936,000
Miscellaneous receivables, net	2,141,000	925,000	54,328,000	(42,718,000)	14,676,000	1,183,000
Total Other Assets	296,593,000	173,352,000	59,823,000	(42,718,000)	487,050,000	449,101,000
Total Admitted Assets	$ 4,683,983,000	$ 4,368,218,000	$ 3,502,303,000	$ (42,718,000)	$ 12,511,786,000	$ 14,454,559,000
Liabilities and Contingency Reserve						
Liabilities						
Benefits	$ 4,245,695,000	$ 3,458,833,000	$ 3,498,427,000	$ -	$ 11,202,955,000	$ 10,793,048,000
Other Liabilities						
Claims administration	204,134,000	331,841,000	-	-	535,975,000	495,262,000
Retrospective rating adjustments	121,690,000	-	-	-	121,690,000	91,159,000
Accrued liabilities						
OPEB claims administration	7,218,000	9,007,000	-	-	16,225,000	13,302,000
OPEB other administration	7,651,000	5,130,000	-	-	12,781,000	10,028,000
Other accrued liabilities	62,730,000	17,529,000	3,876,000	(42,718,000)	41,417,000	55,207,000
Deferred revenue	266,000	107,000	-	-	373,000	106,000
Collateral from securities lending activities	-	-	-	-	-	2,217,078,000
Total Other Liabilities	403,689,000	363,614,000	3,876,000	(42,718,000)	728,461,000	2,882,142,000
Total Liabilities	4,649,384,000	3,822,447,000	3,502,303,000	(42,718,000)	11,931,416,000	13,675,190,000
Contingency Reserve	34,599,000	545,771,000	-	-	580,370,000	779,369,000
Total Liabilities and Contingency Reserve	$ 4,683,983,000	$ 4,368,218,000	$ 3,502,303,000	$ (42,718,000)	$ 12,511,786,000	$ 14,454,559,000

The Notes to the Consolidated Statutory Financial Statements are an integral part of this statement.

The source of this financial information is the Washington State Agency Financial Reporting System with adjustments for Statutory Basis of Accounting.

Consolidated Statutory Statement of Operations and Changes in Contingency Reserve
For the Fiscal Years Ended June 30, 2012 and 2011
(rounded to the nearest $1,000)

	Accident Account	Medical Aid Account	Pension Reserve Account	Total June 30, 2012	Total June 30, 2011
Revenues					
Net standard premiums earned	$ 1,046,714,000	$ 587,552,000	$ -	$ 1,634,266,000	$ 1,504,549,000
Less net retrospective rating adjustments	(170,873,000)	-	-	(170,873,000)	(75,019,000)
Net premiums earned	875,841,000	587,552,000	-	1,463,393,000	1,429,530,000
Net investment income earned	183,848,000	150,032,000	148,012,000	481,892,000	491,654,000
Net fixed income investment realized gains	9,881,000	13,167,000	8,693,000	31,741,000	45,634,000
Net equity investment realized gains	153,550,000	302,141,000	60,339,000	516,030,000	23,134,000
Self-insured administration expense assessments	12,986,000	12,477,000	-	25,463,000	21,721,000
Self-insured second injury pension reserve assessments	-	-	56,600,000	56,600,000	39,605,000
Self-insured cash funded & bonded pension reimbursements	-	-	21,516,000	21,516,000	19,755,000
Fines, penalties, and interest	38,468,000	2,132,000	74,000	40,674,000	42,994,000
Other income	7,512,000	2,144,000	-	9,656,000	9,632,000
Total Revenues Earned	1,282,086,000	1,069,645,000	295,234,000	2,646,965,000	2,123,659,000
Expenses					
Benefits incurred	728,538,000	758,699,000	470,008,000	1,957,245,000	1,601,225,000
Administration expenses incurred:					
Insurance expenses incurred:					
Claims administration expenses incurred	73,845,000	111,033,000	-	184,878,000	159,641,000
Premium administration expenses incurred	16,768,000	17,212,000	-	33,980,000	44,612,000
General insurance administration expenses incurred	12,735,000	6,423,000	-	19,158,000	21,698,000
Other agencies insurance expenses incurred	8,859,000	9,165,000	-	18,024,000	18,069,000
Total administration and insurance expenses incurred	112,207,000	143,833,000	-	256,040,000	244,020,000
Self-insured administration expenses incurred	12,971,000	11,204,000	-	24,175,000	23,875,000
Non-insurance expenses incurred	32,828,000	13,206,000	-	46,034,000	46,236,000
Total Administration Expenses Incurred	886,544,000	926,942,000	470,008,000	2,283,494,000	1,915,356,000
Net Income (Loss) Before Transfers	395,542,000	142,703,000	(174,774,000)	363,471,000	208,303,000
Transfers In (Out)					
Pension funding transfers	(202,104,000)	-	202,104,000	-	-
Pension funding actuarial adjustment	(42,718,000)	-	42,718,000	-	-
Net Transfers In (Out)	(244,822,000)	-	244,822,000	-	-
Net Income	150,720,000	142,703,000	70,048,000	363,471,000	208,303,000
Other Changes in Contingency Reserve					
Equities unrealized gains (losses)	(172,297,000)	(334,110,000)	(76,692,000)	(583,099,000)	370,867,000
Treasury inflation-protected securities unrealized gains	10,389,000	19,309,000	6,973,000	36,671,000	46,077,000
Change in nonadmitted assets	(17,463,000)	1,750,000	(329,000)	(16,042,000)	(27,088,000)
Change in Contingency Reserve, net	(28,651,000)	(170,348,000)	-	(198,999,000)	598,159,000
Beginning contingency reserve, July 1	63,250,000	716,119,000	-	779,369,000	181,210,000
Ending Contingency Reserve, June 30	$ 34,599,000	$ 545,771,000	$ -	$ 580,370,000	$ 779,369,000

The Notes to the Consolidated Statutory Financial Statements are an integral part of this statement.

The source of this financial information is the Washington State Agency Financial Reporting System with adjustments for Statutory Basis of Accounting.

Consolidated Statutory Statement of Cash Flows
For the Fiscal Years Ended June 30, 2012 and 2011
(rounded to nearest $1,000)

	Accident Account	Medical Aid Account	Pension Reserve Account	Total June 30, 2012	Total June 30, 2011
Standard premiums collected	$ 1,036,456,000	$ 578,341,000	$ -	$ 1,614,797,000	$ 1,442,693,000
Less retrospective rating adjustments	(140,342,000)	-	-	(140,342,000)	(98,503,000)
Net premiums collected	896,114,000	578,341,000	-	1,474,455,000	1,344,190,000
Self-insured administration expense reimbursements	12,510,000	12,020,000	-	24,530,000	21,869,000
Self-insured second injury pension reserve reimbursements	-	-	38,640,000	38,640,000	51,913,000
Self-insured cash funded and bonded pension reimbursements	-	-	18,746,000	18,746,000	21,011,000
Fines, penalties, and interest	21,534,000	1,709,000	-	23,243,000	25,893,000
Other income (expenses)	4,310,000	603,000	860,000	5,773,000	10,978,000
Fund transfers in (out)	(161,590,000)	-	161,590,000	-	392,000
Operating Cash Flow In	772,878,000	592,673,000	219,836,000	1,585,387,000	1,476,246,000
Benefits paid	622,719,000	565,350,000	359,269,000	1,547,338,000	1,556,606,000
Administration expenses:					
Insurance expenses:					
Claims administration expenses	57,111,000	84,131,000	-	141,242,000	136,259,000
Premium administration expenses	17,391,000	17,664,000	-	35,055,000	41,873,000
General insurance administration expenses	12,618,000	6,680,000	-	19,298,000	20,588,000
Other agencies insurance expenses	8,770,000	9,143,000	-	17,913,000	18,088,000
Total administration and insurance expenses	95,890,000	117,618,000	-	213,508,000	216,808,000
Self-insured administration expenses	12,471,000	10,848,000	-	23,319,000	23,398,000
Non-insurance expenses	31,424,000	12,714,000	-	44,138,000	44,055,000
Total Administration Expenses Paid	139,785,000	141,180,000	-	280,965,000	284,261,000
Operating Cash Flow Out	762,504,000	706,530,000	359,269,000	1,828,303,000	1,840,867,000
Net Operating Cash Flow Out	10,374,000	(113,857,000)	(139,433,000)	(242,916,000)	(364,621,000)
Investment income - bonds	181,688,000	149,820,000	146,514,000	478,022,000	471,776,000
Investment income - equities	1,967,000	3,235,000	1,641,000	6,843,000	17,081,000
Net realized gains on investments	163,431,000	315,308,000	69,032,000	547,771,000	68,768,000
Net (purchases) sales of investments	(357,083,000)	(352,946,000)	(76,753,000)	(786,782,000)	(186,939,000)
Investment expenses	(1,465,000)	(1,321,000)	(1,038,000)	(3,824,000)	(4,052,000)
Total Investment Cash Flow In (Out)	(11,462,000)	114,096,000	139,396,000	242,030,000	366,634,000
Net Cash Flow In (Out)	(1,088,000)	239,000	(37,000)	(886,000)	2,013,000
Beginning Cash, July 1	4,622,000	1,889,000	1,345,000	7,856,000	5,843,000
Ending Cash, June 30	$ 3,534,000	$ 2,128,000	$ 1,308,000	$ 6,970,000	$ 7,856,000

The Notes to the Consolidated Statutory Financial Statements are an integral part of this statement.
The source of this financial information is Washington State's Agency Financial Reporting System (AFRS) with adjustments for Statutory Basis of Accounting.

Washington State Department of
Labor & Industries

Keep Washington Safe and Working

Notes to the Consolidated Statutory Financial Statements

For the Fiscal Years Ended June 30, 2012 and 2011

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Note 1 - Summary of Significant Accounting Policies

1.A. Nature of Operations

The state of Washington's Department of Labor & Industries (L&I) administers the state's Workers' Compensation Fund. Through Title 51 of the Revised Code of Washington (RCW), Washington State requires all employers, unless exempt, to secure coverage for job-related injuries and illnesses either by paying insurance premiums to the Industrial Insurance Fund or by self-insuring. The agency is the exclusive writer of workers' compensation insurance in the state of Washington for all businesses except the self-insured. Direct private insurance is not authorized, although self-insurers are permitted to reinsure up to 80 percent of their obligations.

Chapter 51.44 RCW provides six benefit accounts: the Accident Account, Medical Aid Account, Pension Reserve Account, Supplemental Pension Account, Second Injury Account, and the Self-Insured Employer Overpayment Reimbursement Account, to primarily make compensation payments to injured workers or to medical providers for rehabilitation services to injured workers. A seventh account, called the Industrial Insurance Rainy Day fund Account, was created during the 2011 Legislative Session. The purpose of the account is to receive transfers of funds from the Accident and Medical Aid Accounts when assets for those accounts combined are between 10 and 30 percent in excess of their funded liabilities. The funds are then set aside to reduce a rate increase or aid businesses during or recovering from economic recessions. The Industrial Insurance Rainy Day Fund Account did not have any activity during or balance at the end of Fiscal Year 2012. These seven accounts are known collectively as the Workers' Compensation Fund.

The Accident, Medical Aid, and Pension Reserve Accounts are referred to as the Industrial Insurance Fund and are the focus of this report. The Supplemental Pension, Second Injury, Self-Insured Employer Overpayment Reimbursement, and Industrial Insurance Rainy Day Fund Accounts are not part of the Industrial Insurance Fund and are not included in this report.

The Industrial Insurance Fund is self-sustaining through the ability to assess the appropriate rates of insurance premiums and prudent investment management. The three accounts are maintained on an actuarially solvent basis, except that a cash-flow basis is used for the components of the Pension Reserve Account when self-insured employers guarantee related benefits with a surety bond. The accompanying consolidated statutory statements report on the financial position and results of operations of the Industrial Insurance Fund.

1.A.1. Description of the Industrial Insurance Fund

The Accident Account pays compensation directly to injured workers for lost wages during temporary disability and permanent partial disability awards. It also pays costs for vocational retraining and for structured settlements. The Structured Settlement Program was created by House Bill 2123 during the 2011 Legislative Session and is a voluntary program in which those who are eligible can negotiate an agreement for the non-medical portion of a claim and receive settlement payment(s).

Pursuant to RCW 51.44.070, funds from the Accident Account are to be transferred to the Pension Reserve Account for the present value of pensions awarded to survivors of fatally injured workers and to workers who have a permanent total disability.

Revenues for this account are from employer-paid premiums based on individual employers' reported payroll hours and are reported net of refunds. Employers may elect to have their premiums retrospectively rated with an annual adjustment for actual benefits incurred. The retrospective adjustment calculation considers both the Accident and Medical Aid Accounts' experience and premiums together and may result in either a rebate of premiums paid or an assessment of additional premiums due. All retrospective premium adjustments are financed entirely through the Accident Account.

On behalf of injured workers, the Medical Aid Account pays for the cost of medical, vocational rehabilitation services, and Stay at Work reimbursements. The Stay at Work Program was also created by House Bill 2123 during the 2011 Legislative Session and is a financial incentive program that encourages employers to bring employees recovering from on-the-job injuries back to light-duty or transitional work.

Equal contributions from employers and employees fund this account. It is the employer's responsibility to collect the employee portion of the medical aid premium and submit the employee and employer contributions to Labor & Industries quarterly.

The Pension Reserve Account pays benefits to all permanently disabled pensioners, including disabled employees of self-insured employers, their dependents, and surviving dependents of fatalities. Funding for pension payments is generated by transfers from the Accident and Second Injury Accounts and cash funded or bonded pension payments from self-insured employers. Funding required to cover estimated present cash value of monthly pension payments is calculated upon the basis of an annuity; such annuity values are based upon L&I's experience as to rates of mortality, disability, remarriage, and interest, according to RCW 51.44.070.

1.B. Accounting Practices and Basis of Presentation

The Industrial Insurance Fund follows the Statements of Statutory Accounting Principles (SSAP) as promulgated by the National Association of Insurance Commissioners (NAIC), as directed by RCW 51.44.115. The SSAP are very conservative in nature and are designed to protect injured workers to ensure that, in the event of liquidation, sufficient amounts have been set aside to provide for outstanding claims. This accounting basis is used to present solvency and the adequacy of premium rates.

SSAP standards are required to be used by property and casualty insurance enterprises in the United States when reporting their financial position to state insurance regulators, subject to any differences prescribed or permitted by each state's law. The NAIC defines prescribed accounting practices as "… those practices that are incorporated directly or by reference by state laws, regulations and general administrative rules applicable to all insurance enterprises domiciled in a particular state. The NAIC Accounting Practices and Procedures Manual (AP&P) is not intended to preempt states' legislative and regulatory authority."[1] Washington's prescribed differences from the NAIC are addressed in RCW 48.13.071, which provides limits on investments. The NAIC defines permitted practices as "…practices specifically requested by an insurer that depart from SSAP and state-prescribed accounting practices, and have received approval from the insurer's domiciliary state regulatory authority."[1]

In accordance with Title 51 RCW and Title 296 of the Washington Administrative Code (WAC), the Industrial Insurance Fund is administered by the Department of Labor & Industries. Pursuant to Title 48 RCW and Title 284 WAC, Labor & Industries is not required to file annual statements with the Washington State Office of the Insurance Commissioner (WSOIC). The Industrial Insurance Fund is not required to report to the WSOIC or complete an annual statement in accordance with the NAIC annual statement filing instructions. Since the Industrial Insurance Fund is not subject to oversight by the WSOIC, there is no requirement that the Industrial Insurance Fund request approval from WSOIC for departures from the SSAP. Thus, we have no such permitted practices.

The following table shows there are no prescribed or permitted practices followed by the Industrial Insurance Fund that differ from SSAP and, therefore, they have no effect on net income or the contingency reserve. The impact of non-tabular discounting on net income and the contingency reserve for the Industrial Insurance Fund is shown in the table below. However, the Industrial Insurance Fund does have a long-established practice of discounting on a non-tabular basis that departs from SSAP No. 65, which allows discounting fixed and reasonably determinable payments on a tabular only basis. Non-tabular discounting is only permitted in certain instances in which states have prescribed or permitted practices to allow it. (See Note 1.C.3 and Note 11.B for additional information on discounting methodology and non-tabular discounting.)

Description	**As of and for the Fiscal Year Ended June 30, 2012**	**As of and for the Fiscal Year Ended June 30, 2011**
1. Net Income, WA basis	$363,471,000	$208,303,000
2. Effect of WA prescribed practices	$0	$0
3. Effect of WA permitted practices	$0	$0
4. Effect of WA practices that depart from SSAP (non-tabular discounting)	$379,588,000	($182,110,000)
5. Net income, NAIC SSAP basis	$743,059,000	$26,193,000
6. Policy holders' surplus, WA Basis	$580,370,000	$779,369,000
7. Effect of WA prescribed practices	$0	$0
8. Effect of WA permitted practices	$0	$0
9. Effect of WA practices that depart from SSAP (non-tabular discounting)	($1,913,503,000)	($2,293,091,000)
10. Policyholders' surplus, NAIC SSAP basis	($1,333,133,000)	($1,513,722,000)

[1] NAIC AP&P Manual as of March 2012, Section: Permitted Practices Advance Notification Requirement, Implementation Questions and Answers, Question 2.

The financial statement layout and terminology were selected based on the terminology and formatting customary to governmental insurance funds. The Industrial Insurance Fund refers to losses as “benefits” and loss adjustment expenses as “claims administration expenses.” Any surplus remaining in the Fund is referred to as “contingency reserve.”

1.B.1. Use of Estimates

The preparation of financial information in conformity with the SSAP requires management to make estimates and assumptions that affect the reported amounts of admitted assets, liabilities, and contingency reserve at the date of the financial information and the reported amounts of revenues and expenses during the reporting period. Material estimates that are susceptible to significant changes include benefit and claims administration liabilities, premium receivables, self-insurance receivables, retrospective rating adjustment liabilities, and accrued liabilities for other postemployment benefits. Actual results could differ materially from those estimates.

Management’s estimates are based on its knowledge of and experience about past and current events and circumstances and its assumptions about conditions it expects will exist in the future. The most significant estimates made in these statutory financial statements are the benefit and claims administration liabilities at the date of the financial information. Factors relevant to the estimation of these liabilities include the estimation of the ultimate frequency and severity of losses, the level of inflation of future medical costs over long periods of time, the future legal environment, and the amount of future expenses required to investigate and settle claims. Management’s estimates are reviewed after the fiscal year-end by a nationally recognized, qualified consulting actuarial firm. The independent actuarial firm’s opinion is included at the end of this report.

1.B.2. Differences between SSAP and GAAP

The SSAP followed by the Industrial Insurance Fund vary in some respects from Generally Accepted Accounting Principles (GAAP) as promulgated by the Financial and Governmental Accounting Standards Boards. Some of the most significant differences between the SSAP and GAAP are as follows:

- Investments in bonds are reported for SSAP at amortized cost or market value based on their NAIC rating; for GAAP, such fixed maturity investments would be designated at purchase as held-to-maturity, trading, or available-for-sale. Held-to-maturity fixed investments would be reported at amortized cost. The remaining fixed maturity investments would be reported at fair value with unrealized holding gains and losses reported in operations for those designated as trading and as a separate component of capital and surplus for those designated as available-for-sale.

- For SSAP, all loan-backed securities are adjusted for the effects of changes in prepayment assumptions using the prospective method, which equates the carrying amount of the investment to the present value of the anticipated future cash flows using a recalculated effective yield. The recalculated yield is then used to accrue income on the investment balance for subsequent accounting periods. If it is determined that a decline in fair value is other-than-temporary, the cost basis of the security is written down to the undiscounted estimated future cash flows. Under GAAP, all securities other than high-quality credit rated securities are adjusted using the prospective method when there is a change in estimated future cash flows. If it is determined that a decline in fair value is other-than-temporary, the cost basis of the security is written down to the discounted fair value. If high-credit quality securities are adjusted, the retrospective method is used, which equates the present value of the actual and anticipated cash flows with the original cost of the investment. The current balance is then increased or decreased to the amount that would have resulted had the revised yield been applied since inception, and the investment income is decreased or increased.

- SSAP assets designated as “nonadmitted assets” are excluded from total admitted assets and defined as assets having economic value other than those which can be used to fulfill policyholder obligations and assets unavailable due to encumbrances or third party interests. These assets consist primarily of premiums in collection that have been outstanding for over ninety days, office furniture, equipment, and prepaid expenses. Nonadmitted assets are charged against the contingency reserve unless otherwise specifically addressed within the NAIC’s Accounting Practices and Procedures Manual. Under GAAP, premium receivables are presented net of allowance for doubtful accounts; furniture and equipment are presented net of accumulated depreciation; and prepaid expenses are presented at full cost.

- SSAP limits the aggregate amount of admitted electronic data processing equipment and operating system software, net of accumulated depreciation, to three percent of the reporting entity’s capital and surplus. Under GAAP, computer equipment and software purchases meeting the state’s capitalization criteria are recorded as assets, less accumulated depreciation, with no limitations.

- The focus of SSAP accounting is solvency; therefore, it is concerned with assets that can be used immediately to cover benefit liabilities. GAAP accounting is focused on “going concern,” which assumes that an entity has the ability to survive, and therefore, assets and liabilities are presented in the order of liquidity and classified as current and non-current.

- The Consolidated Statutory Statement of Operations and Changes in Contingency Reserve presents premiums earned and investment income as the primary revenue sources, and expenses are presented as activities. GAAP presentations separate operating income from investment income, since investment activity is not normally a primary revenue source. GAAP also presents expenses by character rather than by the purpose of the item purchased or service obtained and the net effect of revenues and expenses as a change in net assets.

- Both SSAP and GAAP require the statement of cash flows to be prepared using the direct method. However, the statutory statement of cash flows differs in certain aspects from the presentation required by GAAP. On the SSAP Consolidated Statement of Cash Flows, Cash Flows In includes operating transfers and other income. Cash Flows Out is categorized by benefits paid and administration expenses. The GAAP statement of cash flows includes a reconciliation between operating income from the statement of operations and cash flows from operating activities.

1.C. Significant Accounting Policies

1.C.1. Recognition of Premiums

Premiums are based on individual employers' reported payroll hours and insurance rates based on each employer's risk classification(s) and past experience. In addition to its regular premium plans, the Industrial Insurance Fund offers a retrospective premium rating plan under which an employer's premiums are adjusted annually for up to three years following the plan year, based on the employer's actual loss experience. The first of three annual adjustments to the original premiums is paid or collected from the employers approximately ten months after the end of each plan year in which they are enrolled.

Employers' workers' compensation insurance premiums are due within 30 days following each calendar quarter in which payroll hours are reported. Net premiums receivable reported in the financial statement is an actuarial estimate of the two most recent quarters' uncollected premium balances, based on past collection statistics, growth projection, observed development of premiums reported, statistical analysis, and other factors, including actuarial judgment. This amount represents the estimated premiums that will ultimately be collected. All premium receivables exceeding 90 days in age are adjusted as nonadmitted assets in the current period and are not included in the net premiums receivable amount. For premium receivables over 90 days in age, collection efforts are continued until the premiums are collected or all legal means are exhausted.

According to SSAP No. 60, a premium deficiency reserve is recognized "…when anticipated losses, loss adjustment expenses, and maintenance costs exceed the recorded unearned premium reserve and contingency reserve." Because the Industrial Insurance Fund has no unearned premium reserves or installment premium contracts, no premium deficiency reserve is recorded.

1.C.2. Benefit and Claims Administration Liabilities

The Industrial Insurance Fund establishes benefit and claims administration liabilities arising from its workers' compensation coverage based on estimates of the ultimate cost of benefits that have been reported but not resolved and claims that have been incurred but not reported. The length of time for which such costs must be estimated varies depending on the type of benefit involved. Since actual claim costs depend on complex factors such as inflation, changes in doctrines of legal liabilities, claim adjudication, and judgments, the actual ultimate claim costs may differ from the estimates.

Benefit and claims administration liabilities are recomputed quarterly using a variety of actuarial and statistical techniques. These techniques are used to produce current estimates that reflect recent settlements, claim frequency, expected inflation, and other economic, legal, and social factors. A provision for inflation in the calculation of estimated future benefits is implicit in the calculation, because reliance is placed both on actual historical data that reflects past inflation and on other factors that are considered to be appropriate modifiers of past experience.

Future premium income is not offset against benefit liabilities, because benefit liabilities come from coverage periods for which premiums have, in general, already been fully earned. The obligation to pay benefit and claims administration liabilities is not contingent upon any future premiums for future coverage periods.

Adjustments to benefit and claims administration liabilities are charged or credited to benefit and claims administration expense in the periods in which they are made. Unpaid benefits and claims administration expenses include amounts based on past experience for claims development on reported claims and benefits incurred but not reported. Such liabilities are necessarily based on assumptions and estimates, and while management believes the amount is adequate, the ultimate liability may be in excess of or less than the amount provided. The methods for making such estimates and for establishing the resulting liabilities are continually reviewed, and any adjustments are reflected in the period affected.

1.C.3. Discounting Methodology

The Industrial Insurance Fund discounts benefit and claims administration expense reserves to reflect the time value of money. The Industrial Insurance Fund uses both tabular and non-tabular discounting. Non-tabular discounting is an accounting practice that departs from SSAP No. 65 as disclosed in 1.B. of this note. The bullets below discuss the discount method and rate applied to each discounted liability category.

- The benefit liabilities in the Pension Reserve Account are discounted on a tabular basis at 6.5 percent.

- Liabilities in the Accident Account for pensions incurred but not yet awarded are discounted on both a tabular and non-tabular basis. For each future pension award, the estimated future pension payments are discounted from the anticipated payment dates back to the anticipated date of the pension award on a tabular basis at 6.5 percent. The payments are then discounted from the anticipated date of the pension award back to June 30, 2012, on a non-tabular basis at 2.0 percent.

- All other Accident and Medical Aid Account benefit and claims administration liabilities are discounted on a non-tabular basis at 2.0 percent.

The Industrial Insurance Fund's non-tabular discount rate is set two percentage points less than the five-year average of the twenty-year U.S. Treasury yield, rounded to the nearest half percent. Since interest rates have decreased and have remained low, the non-tabular discount rate dropped from 2.5 percent to 2.0 percent during Fiscal Year 2012. As a result of this non-tabular discount rate change, benefit and claims administration expense liabilities increased.

In the reserving process, the long-term inflation rate assumption is set equal to the non-tabular discount rate, and this long-term inflation rate is the basis for their medical inflation assumptions.

This decrease in the long-term inflation rate lowered the medical inflation assumptions, which reduced the Medical Aid Account benefit and claims administration expense liabilities. In the Medical Aid Account, the effect of the reduction in the medical inflation assumptions largely offsets the effect of the lower discount rate on these expenses.

The net effects of reducing both the non-tabular discount rate and the long-term inflation rate assumptions from 2.5 percent to 2.0 percent were an increase of $81.4 million in benefit liabilities and a decrease of the same amount in contingency reserve, as shown in the table below.

Effects of Non-Pension Discount Rate Change on Benefit and Claims Administration Expense Liabilities
June 30, 2012
(dollars in thousands)

	Long-Term Inflation Rate & Non-Pension Discount Rate @ 2.5%	Effect of Reducing Non-Pension Discount Rate to 2.0%	Effect of Reducing Long-Term Inflation Rate to 2.0%	Long-Term Inflation Rate & Non-Pension Discount Rate @ 2.0%	Net Effect of Changing Long-Term Inflation Rate and Non-Pension Discount Rate: Dollars	Net Effect of Changing Long-Term Inflation Rate and Non-Pension Discount Rate: Percent
Accident Account	$ 4,372,385	$ 77,444	$ -	$ 4,449,829	$ 77,444	1.7%
Medical Aid Account	3,786,716	256,764	(252,806)	3,790,674	3,958	0.1%
	$ 8,159,101	$ 334,208	$ (252,806)	$ 8,240,503	$ 81,402	1.0%

1.C.4. Cash and Cash Equivalents

Cash includes cash in banks, cash on deposit with the Office of the State Treasurer (OST), and cash on hand. It also consists of cash equivalents invested by the OST which are short-term, highly liquid investments that are readily convertible to known amounts of cash and so near their maturity that they present insignificant risk of changes in value because of interest rates. Under RCW 43.08.015, the OST has the statutory responsibility to ensure the effective cash management of state public funds. RCW 43.84.080 authorizes the Treasurer to invest available cash and includes a list of eligible investments.

The beginning and ending cash and cash equivalent amounts on the Consolidated Statutory Statement of Cash Flows do not include short-term investments. It is not practical to include short-term investments because of the volume of transactions and complexity involved in reporting, as they are managed by Washington State Investment Board (WSIB), a separate Washington State agency.

The United States Department of Energy has contracted with L&I to pay benefits to the Industrial Insurance Fund for workers injured on the job at the Hanford nuclear production complex. The Industrial Insurance Fund has received amounts, including trust cash and trust investments in advance, from the U.S. Department of Energy to cover the pension liability for these injured workers. These amounts are not reported in the financial statements.

As of June 30, 2012, trust cash amounted to $89,476 and is available to reimburse the Industrial Insurance Fund for monthly pension payments. In addition, trust investments totaling $3,954,000 were invested in U.S. Treasury Notes and are also available to reimburse the Industrial Insurance Fund for future expenses.

1.C.5. Investments

The Industrial Insurance Fund uses the following accounting policies to value investments:

- Investment grade bonds are stated at amortized cost using the scientific interest method. Non-investment grade bonds with NAIC designations of 3-6 are stated at the lower of amortized cost or fair value. Fair values are reported using pricing sources approved by the NAIC. The Industrial Insurance Fund holds only investment grade securities, as defined by Lehman Barclays Capital Global Family of Fixed Income Indices.

- Short-term investments are stated at amortized cost using the scientific interest method. Per SSAP No. 2, accounting for short-term investments should follow guidance for similar long-term investments (see discussion above on investment grade bonds). Therefore, any short-term bond premiums and discounts are amortized using the scientific interest method.

- Common stocks are stated at fair value.

- Investment grade loan-backed securities are stated at amortized cost. Non-investment grade loan-backed securities with NAIC designations of 3-6 are stated at the lower of amortized cost or fair value. Fair values are reported using pricing sources approved by the NAIC. The Industrial Insurance Fund holds only investment grade securities, as defined by Lehman Barclays Capital Global Family of Fixed Income Indices. In compliance with SSAP No. 43R, changes in currently estimated cash flows are reviewed quarterly using the Bloomberg investment valuation model for prepayment assumptions in valuing mortgage backed securities. These securities are revalued using the prospective adjustment method. See Note 2.G. for other than temporary impairment analysis of mortgage backed securities.

- Treasury Inflation-Protected Securities (TIPS) are indexed and presented net at par and include a consideration of unrealized gains on the change in par in accordance with SSAP Interpretation 01-25. Changes in fair value are not considered until traded.

- Securities Lending Collateral - Cash received as collateral on securities lending transactions and investments made with that cash are reported as assets. Securities received as collateral are reported as assets if the Industrial Insurance Fund has the ability to pledge or sell them without a borrower default. Liabilities resulting from these transactions are also reported in the balance sheet. Securities lending transactions collateralized by securities that the Industrial Insurance Fund does not have the ability to pledge or sell unless the borrower defaults are not reported as assets or liabilities.

1.C.6. Capital Assets

In accordance with the Washington State Office of Financial Management's policy, it is the Industrial Insurance Fund's policy to capitalize:

- All land
- Buildings, building improvements, and leasehold improvements with a cost of $100,000 or greater
- All capital assets with a unit cost of $5,000 or greater, unless otherwise noted
- Infrastructure with a cost of $100,000 or greater
- Intangible assets either purchased or internally developed, with a cost of $1,000,000 or greater, that are "identifiable" by meeting either of the following conditions:
  - The asset is capable of being separated or divided and sold, transferred, licensed, rented, or exchanged; or
  - The asset arises from contractual or other legal rights, regardless of whether those rights are transferable or separable
- All capital assets acquired with a Certificate of Participation

Capital assets are recorded at cost. Capital asset costs include the purchase price plus those costs necessary to place the asset in its intended location and condition for use. Normal maintenance and repair costs that do not materially add to the value or extend the life of capital assets are not capitalized. The cost and related accumulated depreciation of disposed capital assets are removed from the accounting records.

The value of assets constructed for use in the Industrial Insurance Fund includes all direct construction costs and indirect costs that are related to the construction. Net interest costs incurred during the period of construction, if material, is capitalized.

Depreciation and amortization expense is calculated using the straight-line method over the estimated useful lives of the assets. Total depreciation and amortization expense for capital assets was $6.6 million for the fiscal year ended June 30, 2012, and $8.0 million for the fiscal year ended June 30, 2011.

Generally, estimated useful lives are as follows:

- Buildings and building components — 5-50 years
- Furnishings, equipment, and collections — 3-50 years

- Other improvements 3-50 years
- Infrastructure 20-50 years
- Intangible assets with definite useful lives 3-50 years

In accordance with the SSAP, not all capitalized assets are admitted for reporting purposes. Common examples of nonadmitted capital assets are equipment, furniture, and supplies. These nonadmitted assets are adjusted from the respective account’s contingency reserve, and current purchases are immediately expensed. SSAP No. 16 allows electronic data processing equipment (EDP) and operating system software to be admitted up to 3 percent of the contingency reserve; however, the Industrial Insurance Fund takes a more conservative approach and does not admit any EDP equipment or operating system software.

1.C.7. Risk Management

The state of Washington operates a self-insurance liability program pursuant to RCW 4.92.130. The state’s policy is generally not to purchase commercial insurance for the risk of losses to which it is exposed. Instead, the state’s management believes it is more economical to manage its risks internally and set aside assets for claims settlement in the Risk Management Fund, an internal service fund. A limited amount of commercial insurance is purchased for certain liabilities and to limit the exposure to catastrophic losses. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past ten fiscal years. Otherwise, the self-insurance liability program services all claims against the state for injuries and property damage to third parties.

The Workers’ Compensation Fund participates in the state’s self-insurance liability program, in proportion to its anticipated exposure to liability losses, to manage its various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters.

Note 2 - Investments

2.A. Summary of Investment Policies

Under RCW 43.33A.030, trusteeship of the Industrial Insurance Fund’s investments is vested in the voting members of the WSIB. The Legislature established a standard of care for investment of these funds in RCW 43.33A.140. Additionally, the WSIB and its staff must comply with other state laws, such as the Ethics in Public Service Act, Chapter 42.52 RCW, as it makes investment decisions and seeks to meet its investment objectives.

In accordance with RCW 43.33A.110, Industrial Insurance Fund investments are to be managed to limit fluctuations in the industrial insurance premiums and, subject to this purpose, achieve a maximum return at a prudent level of risk. Based on this requirement, the strategic objectives are to:

- Maintain the solvency of the accounts
- Maintain premium rate stability
- Ensure that sufficient assets are available to fund the expected liability payments
- Subject to the objectives above, achieve a maximum return at a prudent level of risk

Performance objectives are intended to provide the WSIB and the Industrial Insurance Fund with a way to measure the success of this investment policy, the overall asset allocation strategy, and the implementation of that strategy over time. First and foremost, the performance of the investment portfolios shall be judged relative to the strategic objectives. With the first three criteria met, the actual rates of return of the portfolios will be compared to the Comparable Market Index (CMI) for each account. The CMI's are developed and calculated with the goal to construct a hypothetical passive portfolio with the duration, asset allocation, and appropriate mix of fixed income sectors based on the individual targets for each Industrial Insurance Fund account. The return for each account's portfolio should not be significantly different from that of its CMI over the long-term.

Eligible Investments - Eligible investments are securities and deposits that are in accordance with the Industrial Insurance Fund's investment policy and RCW 43.33A.110. Eligible investments include:

- U.S. equities
- International equities
- U.S. Treasuries and government agencies
- Credit bonds
- Mortgage-backed securities rated investment grade, as defined by Barclays Capital Global Family of Fixed Income Indices
- Asset-backed securities rated investment grade, as defined by Barclays Capital Global Family of Fixed Income Indices
- Commercial mortgage-backed securities rated investment grade, as defined by Barclays Capital Global Family of Fixed Income Indices
- Investment grade non-U.S. dollar bonds

Investment Restrictions - To meet stated objectives, investments of the Industrial Insurance Fund are subject to the following constraints:

- All assets under the management of the WSIB are to be invested to maximize return at a prudent level of risk in accordance with RCW 43.33A.110 and RCW 43.33A.140.

- Asset allocation will be reviewed every three to four years, or sooner if there are significant changes in funding levels or the liability durations.

- Assets will be rebalanced across asset classes when the fair value of the assets falls outside the policy ranges. The timing of any rebalancing will be based on market opportunities, cash flows, and the consideration of transaction costs; therefore, they need not occur immediately.

- No corporate fixed income issue cost shall exceed three percent of the Fund's fair value at the time of purchase, nor shall its fair value exceed six percent of the Fund's fair value at any time. This rule applies to any specific corporate bond relative to all of the Fund's assets in aggregate, across all accounts and all their asset class holdings.

- The benchmark and structure for U.S. equities will be the broad U.S. stock market as defined by the MSCI US IMI passive mandate. The benchmark and structure for international equities will be the Morgan Stanley Capital International All Country World Ex U.S. Investable Market Index (MSCI ACW Ex U.S. IMI). Both portfolios will be 100 percent passively managed in commingled index funds. The commingled funds may use futures for hedging or establishing a long position.

- The fixed income portfolios' structures vary, depending upon the required duration target. The duration targets will be reviewed every three years, or sooner if there are significant changes in the funding levels or the liability durations.

- The Treasury Inflation-Protected Securities (TIPS) will be managed to plus or minus 20 percent of the duration of the Barclays Capital U.S. TIPS Index.

- Sector allocation of fixed income investments must be managed within the following prescribed ranges:

  - U.S. Treasuries and government agencies — 5 to 25 percent
  - Credit bonds — 20 to 70 percent
  - Asset-backed securities — 0 to 10 percent
  - Commercial mortgage-backed securities — 0 to 10 percent
  - Mortgage-backed securities — 0 to 25 percent

- These targets are long-term in nature. Deviations may occur in the short term as a result of interim market conditions; however, if a range is exceeded, the portfolios must be rebalanced as soon as practical to the target allocations.

- Total holdings of below investment grade credit bonds, as defined by Barclays Capital Global Family of Fixed Income Indices, should not exceed five percent of total fixed income holdings.

2.B. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates over time will adversely affect the fair value of an investment. Effective duration is the measure of a debt investment's exposure to fair value changes arising from changes in interest rates. Effective duration uses the present value of cash flows, weighted as a percentage of the investment's full price. Increases in prevailing interest rates generally translate into decreases in fair values of those investments. The Industrial Insurance Fund does not have a formal policy specifically for interest rate risk.

As of June 30, 2012, the Industrial Insurance Fund's portfolio durations were within effective duration targets listed below:

- Accident Account – within plus or minus 20 percent of a effective duration target of 7 years

- Medical Aid Account – within plus or minus 20 percent of a effective duration target of 6 years

- Pension Reserve Account – within plus or minus 20 percent of a effective duration target of 7 years

It is the goal of the fixed income portfolios to match the target durations. Although there may be differences from the targets due to market conditions, over any extended period of time, those differences should not be material.

The following four tables present the Workers' Compensation Fund's investments by type and provide information about the interest rate risks associated with the investments as of June 30, 2012 and 2011. The tables display various asset classes held by maturity in years, credit ratings and effective durations. They are prepared on a GAAP basis for the Workers' Compensation Fund by the WSIB and include the Supplemental Pension Account, which is not part of the Industrial Insurance Fund. Investments of the Supplemental Pension Account comprise only 0.74 percent of the Workers' Compensation Fund's investments. The information compiled in these tables is not available on a SSAP basis.

Residential mortgage-backed, commercial mortgage-backed and asset-backed securities are reported using the average life within the portfolio. The average life is a calculated estimate of the average time (in years) until maturity for these securities, taking into account possible prepayments of principal. All other securities in this schedule are reported using the stated maturity date.

Schedule of Maturities and Credit Ratings
(dollars in thousands)

June 30, 2012		Maturity					Effective
Investment Type	**Fair Value**	**Less than 1 year**	**1-5 years**	**6-10 years**	**More than 10 years**	**Credit Rating**	**Duration (years)**
Residential mortgage-backed securities	$ 1,743,809	$ 25,143	$ 1,004,023	$ 667,980	$ 46,663	Aaa	4.89
Commercial mortgage-backed securities	429,228	30,322	377,786	21,120	-	Multiple	3.29
Corporate bonds - domestic	3,191,256	203,994	534,684	1,021,460	1,431,118	Multiple	8.71
Corporate bonds - foreign (USD)	2,463,565	267,206	439,806	814,804	941,749	Multiple	7.65
Foreign government and agencies (USD)	941,850	44,791	396,713	303,048	197,298	Multiple	6.34
Suptranational (USD)	184,781	45,792	138,989	-	-	Aaa	2.85
Government securities - domestic:							
U.S. Government treasuries	777,685	145,357	599,356	32,972	-	Aaa	2.71
Treasury inflation-protected securities	1,889,532	-	597,280	618,101	674,151	Aaa	4.71
	11,621,706	$ 762,605	$ 4,088,637	$ 3,479,485	$ 3,290,979		
Commingled index funds - domestic	951,396						
Commingled index funds - foreign	628,820						
Money market funds	119,900						
Total investments not categorized	1,700,116						
Total	$ 13,321,822						

Schedule of Maturities and Credit Ratings
(dollars in thousands)

June 30, 2011		Maturity					Effective
Investment Type	**Fair Value**	**Less than 1 year**	**1-5 years**	**6-10 years**	**More than 10 years**	**Credit Rating**	**Duration (years)**
Residential mortgage-backed securities	$ 1,666,287	$ 8,000	$ 563,234	$ 741,507	$ 353,546	Aaa	7.22
Commercial mortgage-backed securities	455,538	55,218	399,584	736	-	Multiple	3.44
Corporate bonds - domestic	3,012,126	87,788	610,473	974,663	1,339,202	Multiple	8.29
Corporate bonds - foreign (USD)	2,222,468	32,002	618,750	758,732	812,984	Multiple	7.52
Foreign government and agencies (USD)	660,072	-	258,272	330,012	71,788	Multiple	5.50
Supranational (USD)	296,350	41,778	151,290	103,282	-	Aaa	3.17
Government securities - domestic:							
U.S. Government treasuries	703,731	544,495	130,347	28,889	-	Aaa	1.29
Treasury inflation-protected securities	1,714,801	-	591,980	562,188	560,633	Aaa	4.97
	10,731,373	$ 769,281	$3,323,930	$ 3,500,009	$3,138,153		
Commingled index funds - domestic	975,192						
Commingled index funds - foreign	664,049						
Money market funds	142,101						
Total investments not categorized	1,781,342						
Total	$ 12,512,715						

Investments with multiple credit ratings are presented using the Moody's rating scale as follows at June 30, 2012 and 2011:

Additional Credit Rating Disclosure
(in thousands)

June 30, 2012	Investment Type				
Moody's Equivalent Credit Rating	Commercial Mortgage-Backed Securities	Corporate Bonds - Domestic	Corporate Bonds-Foreign (USD)	Foreign Government and Agencies (USD)	Total
Aaa	$ 332,935	$ 6,101	$ -	$ 166,302	$ 505,338
Aa1	-	-	-	-	-
Aa2	-	-	-	53,237	53,237
Aa3	96,293	226,940	224,346	139,208	686,787
A1	-	178,665	225,957	248,946	653,568
A2	-	762,672	35,017	-	797,689
A3	-	481,087	313,892	-	794,979
Baa1	-	558,674	425,599	27,298	1,011,571
Baa2	-	770,301	636,284	146,051	1,552,636
Baa3	-	123,108	443,673	83,253	650,034
Other	-	83,708	158,797	77,555	320,060
Total Fair Value	$ 429,228	$ 3,191,256	$ 2,463,565	$ 941,850	$ 7,025,899

Additional Credit Rating Disclosure
(in thousands)

June 30, 2011	Investment Type				
Moody's Equivalent Credit Rating	Commercial Mortgage-Backed Securities	Corporate Bonds - Domestic	Corporate Bonds-Foreign (USD)	Foreign Government and Agencies (USD)	Total
Aaa	$ 412,044	$ 5,021	$ -	$ 86,714	$ 503,779
Aa1	-	-	-	-	-
Aa2	-	-	89,115	119,659	208,774
Aa3	43,494	253,467	200,994	90,211	588,166
A1	-	306,798	210,733	197,611	715,142
A2	-	658,343	51,648	-	709,991
A3	-	412,324	297,614	14,193	724,131
Baa1	-	504,802	278,461	21,423	804,686
Baa2	-	593,932	524,950	84,296	1,203,178
Baa3	-	187,432	436,983	25,490	649,905
Other	-	90,007	131,970	20,475	242,452
Total Fair Value	$ 455,538	$ 3,012,126	$ 2,222,468	$ 660,072	$ 6,350,204

The following additional tables are included to summarize the different classes of investments held by the Industrial Insurance Fund as they are rated by the National Association of Insurance Commissioners (NAIC). There were not any securities with an NAIC rating higher than 3 at the fiscal years ended June 30, 2012 and 2011.

Estimated Fair Value of Securities by NAIC Designation
(in thousands)

June 30, 2012	**NAIC Designation**			
Investment Type	**1**	**2**	**3**	**Total**
U.S. Government obligations, excluding mortgage-backed securities	$ 2,422,445	$ -	$ -	$ 2,422,445
All other government obligations	102,307	-	-	102,307
Public utilities (unaffiliated)	644,921	569,193	10,937	1,225,051
Commercial mortgage-backed securities	430,064	-	-	430,064
Residential mortgage-backed securities	1,743,786	-	-	1,743,786
Industrial and miscellaneous (unaffiliated), excluding mortgage-backed securities	2,550,436	2,589,175	309,764	5,449,375
Total	$ 7,893,959	$ 3,158,368	$ 320,701	$ 11,373,028

Estimated Fair Value of Securities by NAIC Designation
(in thousands)

June 30, 2011	**NAIC Designation**			
Investment Type	**1**	**2**	**3**	**Total**
U.S. Government obligations, excluding mortgage-backed securities	$ 2,253,698	$ -	$ -	$ 2,253,698
All other government obligations	100,977	-	-	100,977
Public utilities (unaffiliated)	590,135	427,280	10,327	1,027,742
Commercial mortgage-backed securities	454,773	-	-	454,773
Residential mortgage-backed securities	1,666,257	-	-	1,666,257
Industrial and miscellaneous (unaffiliated), excluding mortgage-backed securities	2,608,742	2,241,912	232,825	5,083,479
Total	$ 7,674,582	$ 2,669,192	$ 243,152	$ 10,586,926

2.C. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The rated debt investments of the Industrial Insurance Fund as of June 30, 2012, were rated by Moody's and/or an equivalent national rating organization.

Concentration of Credit Risk - Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single issuer. The Industrial Insurance Fund's policy states that no corporate fixed income issue cost shall exceed three percent of the Fund's fair value at the time of purchase, nor shall its fair value exceed six percent of the Fund's fair value at any time. There was no concentration of credit risk as of June 30, 2012.

Custodial Credit Risk - Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty to a transaction, the Industrial Insurance Fund's accounts will not be able to recover the value of investments that are in the possession of an outside party. The Fund mitigates custodial credit risk by having its investment securities held by its custodian. Also, investment securities are registered in the name of the WSIB for the benefit of the Fund, excluding cash and cash equivalents and repurchase agreements held as securities lending collateral.

2.D. Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The Industrial Insurance Fund does not have a formal policy to limit foreign currency risk. The Fund had $628.8 million and $664.0 million invested in an international commingled equity index fund at June 30, 2012 and 2011, respectively. As such, no currency denomination risk was present at June 30, 2012.

2.E. Derivatives

The Industrial Insurance Fund is authorized to utilize various derivative financial instruments, including mortgage-backed securities, financial futures, forward contracts, interest rate and equity swaps, and options to manage its exposure to fluctuations in interest and currency rates while increasing portfolio returns.

Derivative transactions involve, to varying degrees, market and credit risk. The Industrial Insurance Fund mitigates market risks arising from derivative transactions by requiring collateral in cash and investments to be maintained equal to the securities positions outstanding, thereby prohibiting the use of leverage or speculation. Credit risks arising from derivative transactions are mitigated by selecting and monitoring creditworthy counterparties and collateral issuers.

Consistent with the Industrial Insurance Fund's authority to invest in derivatives, international active equity managers may make limited investments in financial futures, forward contracts, or other derivative securities to manage exposure to currency rate risk and equitize excess cash holdings. No such derivative securities were held as of June 30, 2012.

Domestic and foreign passive equity index fund managers may also utilize various derivative securities to manage exposure to risk and increase portfolio returns. Information on the extent of use and holdings of derivative securities by passive equity index fund managers is unavailable. The only derivative securities held directly by the Industrial Insurance Fund were collateralized mortgage obligations (CMOs) of $1.7 billion for both fiscal years ended June 30, 2012 and 2011.

2.F. Reverse Repurchase Agreements

State law permits the Industrial Insurance Fund to enter into reverse repurchase agreements, i.e., a sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The fair value of the securities underlying reverse repurchase agreements normally exceeds the cash received, providing the dealers a margin against a decline in fair value of the securities. If the dealers default on their obligations to resell these securities to the state or provide securities or cash of equal value, the Industrial Insurance Fund would suffer an economic loss equal to the difference between the fair value plus accrued interest of the underlying securities and the agreement obligation, including accrued interest.

There were no reverse repurchase agreements during Fiscal Years 2012 and 2011, and there were no liabilities outstanding as of June 30, 2012 and 2011.

2.G. Bonds

At June 30, 2012 and 2011, bonds were comprised of U.S. Government, other governments, corporate, and mortgage-backed securities with an aggregate book adjusted carrying value of $10,245,715,000 and $9,942,638,000 and fair value of $11,373,029,000 and $10,586,926,000, respectively, as shown in the following tables:

Gross Unrealized Gains and Losses
(in thousands)

June 30, 2012 Investment Type	Book Adjusted Carrying Value	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government obligations, excluding mortgage-backed securities	$ 2,361,181	$ 112,116	$ (50,853)	$ 2,422,444
All other government obligations	89,670	12,636	-	102,306
Public utilities - unaffiliated	1,033,583	191,469	-	1,225,052
Mortgage-backed securities	1,891,874	281,977	-	2,173,851
Industrial and miscellaneous (unaffiliated), excluding mortgage-backed securities	4,869,407	583,505	(3,536)	5,449,376
Total	$ 10,245,715	$ 1,181,703	$ (54,389)	$ 11,373,029

Gross Unrealized Gains and Losses
(in thousands)

June 30, 2011 Investment Type	Book Adjusted Carrying Value	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government obligations, excluding mortgage-backed securities	$ 2,285,566	$ 16,258	$ (48,126)	$ 2,253,698
All other government obligations	89,633	11,344	-	100,977
Public utilities - unaffiliated	938,128	93,629	(4,015)	1,027,742
Mortgage-backed securities	1,922,353	198,835	(158)	2,121,030
Industrial and miscellaneous (unaffiliated), excluding mortgage-backed securities	4,706,958	389,517	(12,996)	5,083,479
Total	$ 9,942,638	$ 709,583	$ (65,295)	$ 10,586,926

Gross unrealized losses on bonds, the fair value of the related bonds aggregated by investment category, and length of time that individual bonds have been in a continuous unrealized loss position, at June 30, 2012 and 2011, were as follows:

Bonds with Unrealized Losses
(in thousands)

June 30, 2012	**Less than 12 Months**		**12 Months or Longer**		**Total**	
Investment Type	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U.S. Government obligations, excluding mortgage-backed securities	$ 173,686	$ (1,119)	$ 463,394	$ (49,734)	$ 637,080	$ (50,853)
All other government obligations	-	-	-	-	-	-
Public utilities (unaffiliated)	-	-	-	-	-	-
Mortgage-backed securities	-	-	-	-	-	-
Industrial and miscellaneous (unaffiliated), excluding mortgage-backed securities	139,042	(2,210)	23,070	(1,326)	162,112	(3,536)
Total	$ 312,728	$ (3,329)	$ 486,464	$ (51,060)	$ 799,192	$ (54,389)

Bonds with Unrealized Losses
(in thousands)

June 30, 2011	**Less than 12 Months**		**12 Months or Longer**		**Total**	
Investment Type	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U.S. Government obligations, excluding mortgage-backed securities	$ 165,634	$ (4,150)	$ 692,961	$ (43,975)	$ 858,595	$ (48,125)
All other government obligations	-	-	-	-	-	-
Public utilities (unaffiliated)	90,632	(4,015)	-	-	90,632	(4,015)
Mortgage-backed securities	11,378	(158)	-	-	11,378	(158)
Industrial and miscellaneous (unaffiliated), excluding mortgage-backed securities	566,022	(10,871)	33,654	(2,126)	599,676	(12,997)
Total	$ 833,666	$ (19,194)	$ 726,615	$ (46,101)	$ 1,560,281	$ (65,295)

In compliance with SSAP No. 26, management has looked at all bonds in an unrealized loss position and used several categories of information to determine whether any impairment is other-than-temporary. The information considered included general market conditions, industry or company financial prospects, an issuer’s fundamental credit difficulties, and the length of time and the extent to which the fair value had been below cost. Management has no intention of selling these securities and does not believe these impairments are other-than-temporary.

Similarly, in compliance with SSAP No. 43R, management has looked at mortgage-backed securities with a fair value less than the book adjusted carrying value and has used several categories of information to determine whether any impairment is other-than-temporary. The WSIB uses the Bloomberg investment valuation model for prepayment assumptions and determining currently estimated cash flows in valuing mortgage-backed securities. The factors that are considered include discounted cash flow on an investment, the length of time and amount of impairment, forecasts, market data, and financial condition of the issuer(s). As of June 30, 2012, no mortgage-backed securities have been determined to be other than temporarily impaired.

The following tables summarize realized gains or losses of bonds that were sold during Fiscal Years 2012 and 2011:

Bonds Redeemed or Sold
(in thousands)

June 30, 2012 **Investment Type**	**Realized Gains**	**Realized Losses**	**Net Realized Gains (Losses)**
U.S. Government obligations, excluding mortgage-backed securities	$ 449	$ -	$ 449
Public utilities (unaffiliated)	2,415	-	2,415
Mortgage-backed securities	703	(227)	476
Industrial and miscellaneous (unaffiliated), excluding mortgage-backed securities	29,080	(679)	28,401
Total	$ 32,647	$ (906)	$ 31,741

Bonds Redeemed or Sold
(in thousands)

June 30, 2011 **Investment Type**	**Realized Gains**	**Realized Losses**	**Net Realized Gains (Losses)**
U.S. Government obligations, excluding mortgage-backed securities	$ 13,806	$ -	$ 13,806
Mortgage-backed securities	897	(400)	497
Industrial and miscellaneous (unaffiliated), excluding mortgage-backed securities	33,647	(2,316)	31,331
Total	$ 48,350	$ (2,716)	$ 45,634

The amortized costs and estimated fair value of bonds at June 30, 2012 and 2011, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities, because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Bonds by Maturity
(in thousands)

	June 30, 2012		**June 30, 2011**	
	Book Adjusted Carrying Value	**Estimated Fair Value**	**Book Adjusted Carrying Value**	**Estimated Fair Value**
Due in less than one year	$ 719,740	$ 734,560	$ 732,131	$ 739,839
Due in over one year through five years	2,601,891	2,672,650	2,286,432	2,376,300
Due in over five years through ten years	2,424,960	2,708,501	2,699,751	2,922,324
Due in over ten years	4,499,123	5,257,317	4,224,324	4,548,463
Total	$ 10,245,714	$ 11,373,028	$ 9,942,638	$ 10,586,926

2.H. Fair Value Measurements

The Industrial Insurance Fund has categorized its investments that are reported on the Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve at fair value into a three-level hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The three-level hierarchy is based on the degree of subjectivity inherent in the valuation method by which fair value was determined. The three levels are defined as follows:

- Level 1 - Quoted prices in active markets for identical assets or liabilities

- Level 2 - Inputs other than level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that can be corroborated by observable market data for substantially the full term of the assets or liabilities.

- Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The asset's or liability's fair value measurement level within the hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value:

- Industrial & miscellaneous bonds - valued based on NAIC market values

- Equities - valued based on the underlying equity

- Other invested assets - value based on the underlying equity

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of the future fair values. The Industrial Insurance Fund has determined that its valuation methods are appropriate and consistent with other market participants; however, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following tables present the financial instruments related to the Fund's assets carried at fair value as of June 30, 2012 and 2011, by the SSAP No. 100 valuation hierarchy.

Investment Assets Carried at Fair Value
June 30, 2012
(in thousands)

	Investment Assets Carried at Fair Value			
	Level 1	**Level 2**	**Level 3**	**Total**
Industrial and miscellaneous bonds	$ -	$ 178,945	$ -	$ 178,945
Equities	-	1,580,216	-	1,580,216
Other invested assets	-	82,211	-	82,211
Total Assets at Fair Value	$ -	$ 1,841,372	$ -	$ 1,841,372

Investment Assets Carried at Fair Value
June 30, 2011
(in thousands)

	Investment Assets Carried at Fair Value			
	Level 1	**Level 2**	**Level 3**	**Total**
Industrial and miscellaneous bonds	$ -	$ 62,306	$ -	$ 62,306
Equities	-	1,639,241	-	1,639,241
Other invested assets	-	114,550	-	114,550
Total Assets at Fair Value	$ -	$ 1,816,097	$ -	$ 1,816,097

Only bonds with an NAIC rating of 3-6 and a fair value lower than the book adjusted value are carried at fair value on the financial statements. On June 30, 2012, there were eleven bonds in this category with fair values totaling $178,945,000. On June 30, 2011, there were six bonds in this category with a fair value totaling $62,306,000.

At the end of each reporting period, the Industrial Insurance Fund evaluates whether or not any event has occurred or circumstances have changed that would cause an instrument to be transferred between Levels 1 and 2. This policy also applies to transfers into or out of Level 3. During the current year, no transfers into or out of Levels 1, 2 or 3 were required.

The fair value of bonds categorized as Level 2 were valued using a market approach. These valuations were determined to be Level 2 valuations, as quoted market prices for similar instruments in an active market were utilized. This was accomplished by the use of matrix pricing. Matrix pricing takes quoted prices of bonds with similar features and applies analytic methods to determine the fair value of bonds held.

The following tables reflect the fair values and admitted values of all admitted assets and liabilities. The fair values are also categorized into the three-level hierarchy as described above.

Investment Assets at Fair Value
June 30, 2012
(in thousands)

	Fair Value	Admitted Value	Level 1	Level 2	Level 3	Total
Bonds	$ 11,373,028	$ 10,245,714	$ -	$ 11,373,028	$ -	$ 11,373,028
Equities	1,580,216	1,580,216	-	1,580,216	-	1,580,216
Other invested assets	82,211	82,211	-	82,211	-	82,211
Total Assets at Fair Value	$ 13,035,455	$ 11,908,141	$ -	$ 13,035,455	$ -	$ 13,035,455

Investment Assets at Fair Value
June 30, 2011
(in thousands)

	Fair Value	Admitted Value	Level 1	Level 2	Level 3	Total
Bonds	$ 10,586,927	$ 9,942,638	$ -	$ 10,586,927	$ -	$ 10,586,927
Equities	1,639,241	1,639,241	-	1,639,241	-	1,639,241
Other invested assets	114,550	114,550	-	114,550	-	114,550
Total Assets at Fair Value	$ 12,340,718	$ 11,696,429	$ -	$ 12,340,718	$ -	$ 12,340,718

Note 3 - Real Estate and Improvements

At June 30, 2012 and 2011, the Accident and Medical Aid Accounts admitted only land, buildings, and improvements, net of accumulated depreciation and encumbrances.

SSAP No. 40 requires that buildings more than 50 percent occupied by the reporting entity be categorized as a real estate investment and that depreciation and interest expense be classified as investment expenses. The building occupied by the Industrial Insurance Fund's employees is financed through general obligation bonds of the state of Washington. The remaining balance due on the bonds as of June 30, 2012, was $14.9 million. Due to indirect ownership by the state of Washington, the land, building, and improvements are not shown as a real estate investment of the Industrial Insurance Fund. The related interest and depreciation expenses are allocated between administrative and non-insurance expenses based on percentage of use by employees.

Real Estate and Improvements
(in thousands)

	June 30, 2012	June 30, 2011
Land	$ 3,204	$ 3,204
Building occupied by Industrial Insurance Fund	65,134	65,134
Improvements, other than buildings	1,020	1,020
Encumbrances	(14,875)	(18,080)
Accumulated depreciation - building	(26,288)	(24,934)
Accumulated depreciation - improvements	(397)	(377)
Total	$ 27,798	$ 25,967

Note 4 - Investment Income

The Industrial Insurance Fund does not admit investment income due and accrued if amounts are over 90 days past due. As of June 30, 2012 and 2011, all investment income due and accrued was admitted, with balances accrued by security type as summarized in the following table.

Admitted Interest Income Due and Accrued
(in thousands)

	June 30, 2012	June 30, 2011
U.S. government obligations, excluding mortgage-backed securities	$ 13,831	$ 13,473
All other government obligations	486	485
Public utilities (unaffiliated)	16,209	15,221
Mortgage-backed securities	8,563	8,949
Industrial and miscellaneous (unaffiliated), excluding mortgage-backed securities	70,500	70,418
Other interest	28	390
Total	$ 109,617	$ 108,936

The following table provides details for net investment income by security type for the fiscal years ended June 30, 2012 and 2011.

Net Investment Income Earned
(in thousands)

	June 30, 2012	June 30, 2011
U.S. government obligations, excluding mortgage-backed securities	$ 33,005	$ 34,262
All other government obligations	4,354	4,354
Public utilities (unaffiliated)	58,690	56,825
Mortgage-backed securities	103,300	111,636
Industrial and miscellaneous (unaffiliated), excluding mortgage-backed securities	273,400	260,038
Total Bond Interest	472,749	467,115
Equities dividends	6,843	17,080
Net securities lending income	5,120	5,565
Other interest and litigation income	907	5,808
Amortization	139	88
Gross investment income	485,758	495,656
Investment expenses	(3,866)	(4,002)
Total Net Investment Income Earned	$ 481,892	$ 491,654

<u>Note 5 - Retirement Plans, Compensated Absences, Deferred Compensation Plan, and Other Postemployment Benefits</u>

5.A. Retirement Plans

Industrial Insurance Fund employees participate in the Washington State Public Employees' Retirement System (PERS), administered by the Department of Retirement Systems. PERS is a cost-sharing multiple-employer retirement system comprised of three separate plans for membership purposes: Plans 1 and 2 are defined benefit plans, and Plan 3 is a combination defined benefit/defined contribution plan. PERS participants who joined the system by September 30, 1977, are Plan 1 members. Those who joined on or after October 1, 1977, and by February 28, 2002, are Plan 2 members unless they exercise an option to transfer their membership to Plan 3. PERS participants joining the system on or after March 1, 2002, have the irrevocable option of choosing membership in either PERS Plan 2 or PERS Plan 3.

Under PERS, the employee and employer contribute a percentage of the employee's compensation. The Industrial Insurance Fund contributed $9,858,778 and $7,378,462 to PERS during the fiscal years ended June 30, 2012 and 2011, respectively.

An actuarial valuation of the PERS plan for the Industrial Insurance Fund as a stand-alone entity is not available. Pension note disclosures for PERS are included in the Comprehensive Annual Financial Report for the state of Washington. A copy of this report may be obtained by contacting the Accounting Division of the Office of Financial Management at P.O. Box 43113, Olympia, Washington 98507-3113 or online at http://www.ofm.wa.gov/cafr.

5.B. Compensated Absences

Industrial Insurance Fund employees accrue vested annual leave at a variable rate based on years of service. In general, accrued annual leave cannot exceed 240 hours at the employee's anniversary date.

Employees accrue sick leave at the rate of one day per month without limitation on the amount that can be accumulated. Sick leave is not vested; i.e., the Industrial Insurance Fund does not pay employees for unused sick leave upon termination except upon employee death or retirement. At death or retirement, the Industrial Insurance Fund is liable for 25 percent of the employee's accumulated sick leave. In addition, the Industrial Insurance Fund has a "sick leave buyout option" in which, each January, employees who accumulate sick leave in excess of 480 hours may redeem sick leave earned but not taken during the previous year at the rate of one day's pay in exchange for each four days of sick leave.

It is the Industrial Insurance Fund's policy to liquidate unpaid compensated absence balances outstanding at June 30 with future resources, rather than advance funding it with currently available expendable financial resources.

The Industrial Insurance Fund recognizes the expense and accrues a liability for annual leave and estimated sick leave buyout, including related payroll taxes and benefits as applicable, as the leave is earned. The annual leave and sick leave accrued liability was $13,527,582 and $12,597,118 at June 30, 2012 and 2011, respectively.

5.C. Deferred Compensation Plan

Industrial Insurance Fund employees have the option to participate in the state of Washington's Deferred Compensation Plan (DCP). There are no contributions made on behalf of employees to the Deferred Compensation Plan by the Industrial Insurance Fund. The Department of Retirement Systems administers the DCP and contracts with a third party (currently Great-West Retirement Services) for record keeping and other administrative services. The Washington State Investment Board selects and monitors DCP's investment options based on advice and recommendations provided by the Employee Retirement Benefits Board.

5.D. Other Postemployment Benefits

The Industrial Insurance Fund participates fully in the Other Postemployment Benefit (OPEB) plan administered by the Washington State Health Care Authority (HCA) under the auspices of the Public Employees Benefits Board (PEBB).

The following table shows components of the Industrial Insurance Fund's OPEB costs for Fiscal Year 2012, the amount actually contributed to the plan, and changes in the Industrial Insurance Fund's net OPEB obligation (NOO):

OPEB Obligation (NOO)

	June 30, 2012	June 30, 2011
NOO, July 1	$ 23,331,132	$ 17,469,300
Annual OPEB costs	7,796,000	7,932,467
Contribution made	(2,121,000)	(2,070,635)
NOO, June 30	$ 29,006,132	$ 23,331,132

The above information was provided by the Washington State Office of Financial Management. The Industrial Insurance Fund's OPEB plan represents 2.27 percent of the state of Washington's OPEB plan as of both June 30, 2012 and 2011.

The information below fully discloses the state of Washington's information with regard to funding policy, annual OPEB costs and contributions made, the funded status and funding progress of the employer individual plan, as well as actuarial methods and assumptions used. As the Industrial Insurance Fund participates in this multiple-employer plan, no stand-alone information for the Industrial Insurance Fund is available. The state of Washington's OPEB plan does not issue a financial report.

Plan Description and Funding Policy

The state of Washington, through the HCA, administers an agent multiple-employer other postemployment benefit plan per RCW 41.05.065. The HCA is authorized to design benefits and determine the terms and conditions of employee and retired employee participation and coverage, including establishment of eligibility criteria for both active and retired employees. PEBB programs include medical, dental, life, and long-term disability insurance.

Employers participating in the PEBB plan include the state (which includes general government agencies and higher education institutions), 54 of the state's K-12 schools and educational service districts (ESDs) and 207 political subdivisions and tribal governments. Additionally, the PEBB plan is available to the retirees of the remaining 246 K-12 schools and ESDs.

As of June 30, 2012, membership in the PEBB plan consisted of the following:

PEBB Plan Membership
June 30, 2012

	Active Employees	Retirees[1]	Total
State	106,255	27,807	134,062
K-12 schools and ESDs[2]	1,800	29,245	31,045
Political subdivisions	11,375	1,261	12,636
Total	119,430	58,313	177,743

[1]Retirees include retired employees, surviving spouses, and terminated members entitled to a benefit.
[2]In Fiscal Year 2012, there were 98,349 full-time equivalent active employees in the 246 K-12 schools and ESDs that elected to limit participation in PEBB only to their retirees.

As of June 30, 2011, membership in the PEBB plan consisted of the following:

PEBB Plan Membership
June 30, 2011

	Active Employees	Retirees[1]	Total
State	108,251	28,385	136,636
K-12 schools and ESDs[2]	2,009	27,159	29,168
Political subdivisions	11,753	1,188	12,941
Total	122,013	56,732	178,745

[1]Retirees include retired employees, surviving spouses, and terminated members entitled to a benefit.
[2]In Fiscal Year 2011, there were 99,896 full-time equivalent active employees in the 246 K-12 schools and ESDs that elected to limit participation in PEBB only to their retirees.

For Fiscal Years 2012 and 2011, the estimated monthly cost for PEBB benefits for active employees (averaged across all plans and tiers) was as follows:

PEBB Benefits by Fiscal Year

	June 30, 2012	June 30, 2011
Required Premium[1]		
Medical	$ 880	$ 805
Dental	83	81
Life	5	5
Long-term disability	2	2
Total	$ 970	$ 893
Employer contribution	$ 852	$ 799
Employee contribution	118	94
Total	$ 970	$ 893

[1] Per Index Rate Model 3.60 for Fiscal Year 2012 and 7.2 for Fiscal Year 2011

The relationship between the PEBB OPEB plan and its member employers and their employees and retirees is not formalized in a contract or plan document. Rather, the benefits are provided in accordance with a substantive plan. A substantive plan is one in which the plan terms are understood by the employers and plan members. This understanding is based on communications between the HCA, employers and plan members, and the historical pattern of practice with regard to the sharing of benefit costs.

The PEBB retiree OPEB plan is available to employees who elect to continue coverage and pay the administratively established premiums at the time they retire under the provisions of the retirement system to which they belong. Retirees' access to PEBB plans depends on the retirement eligibility of their respective retirement system. PEBB members are covered in the following retirement systems: Public Employees' Retirement System, Public Safety Employees' Retirement System, Teachers' Retirement System, School Employees' Retirement System, Washington State Patrol Retirement System, and Higher Education.

Per RCW 41.05.022, retirees who are not yet eligible for Medicare benefits may continue participation in the state's non-Medicare community-rated health insurance risk pool on a self-pay basis. Retirees in the non-Medicare risk pool receive an implicit subsidy. The implicit subsidy exists because retired members pay a premium based on a claims experience for active employees and other non-Medicare retirees. The subsidy is valued using the difference between the age-based claim costs and the premium. In Calendar Year 2012, the average weighted implicit subsidy is projected to be $326 per member per month, and in Calendar Year 2011, the average weighted implicit subsidy was valued at $301 per member per month.

Retirees who are enrolled in both Parts A and B of Medicare may participate in the state's Medicare community-rated health insurance risk pool. Medicare retirees receive an explicit subsidy in the form of reduced premiums. Annually, the HCA administrator recommends an amount for the next calendar year's explicit subsidy for inclusion in the Governor's budget. In Calendar Year 2012, the explicit subsidy is $150 per member per month, and in Calendar Year 2011, the explicit subsidy was $183 per member per month.

Retirees participating in the PEBB life insurance program received an explicit subsidy of $5 per member per month in Calendar Year 2011. The retiree subsidy of life insurance was eliminated, effective January 2012.

Administrative costs, as well as implicit and explicit subsidies, are funded by required contributions from participating employers. The subsidies provide monetary assistance for medical and life insurance benefits.

Contributions are set each biennium as part of the budget process. In Fiscal Years 2012 and 2011, the costs of the subsidies were approximately 6.5 percent and 6.8 percent of the cost of benefits for active employees, respectively. The benefits are funded on a pay-as-you-go basis.

The PEBB OPEB plan is accounted for as an agency fund on an accrual basis. The plan has no investments or other assets. The PEBB OPEB plan does not issue a publicly available financial report.

For information on the results of an actuarial valuation of the employer-provided subsidies associated with the PEBB plan, refer to:
http://osa.leg.wa.gov/Actuarial_services/OPEB/OPEB.htm.

Annual OPEB Cost and Net OPEB Obligation

The state's (general government agencies and higher education institutions) annual OPEB cost (expense) is calculated based on the annual required contribution (ARC) of the state as the employer, an amount actuarially determined.

The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal costs each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.

The following table shows the components of the state's annual OPEB cost for Fiscal Year 2012 and 2011, the amount actually contributed to the plan, and changes in the state's net OPEB obligation (NOO):

OPEB Cost Components
(in thousands)

	June 30, 2012	June 30, 2011
Annual required contribution	$ 320,991	$ 320,991
Interest on NOO	46,250	35,004
Amortization of NOO	(36,954)	(27,427)
Annual OPEB cost	330,287	328,568
Contributions made	(78,673)	(78,673)
Increase in NOO	251,614	249,895
NOO, July 1	1,027,767	777,872
NOO, June 30	$ 1,279,381	$ 1,027,767

The state's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation was as follows:

OPEB History (dollars in thousands)					
Fiscal Year Ended		Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed		Net OPEB Obligation
June 30, 2012	$	330,286	23.8%	$	1,279,381
June 30, 2011	$	328,568	23.9%	$	1,027,767
June 30, 2010	$	354,420	19.8%	$	777,872

Funded Status and Funding Progress

Actuarial valuations are performed on a two year basis. Therefore, the following tables reflect the latest valuations as of June 30, 2011 of the prior fiscal period.

The funded status of the plan as of June 30, 2011 and 2010 are based on the latest actuarial valuation dates available, January 1, 2011 and 2009, respectively, was as follows:

OPEB Funded Status (dollars in thousands)				
		June 30, 2011		June 30, 2010
Actuarial accrued liability (AAL)	$	3,491,970	$	3,786,869
Actuarial value of plan assets		-		-
Unfunded actuarial accrued liability (UAAL)	$	3,491,970	$	3,786,869
Funded ratio (actuarial value of plan assets/AAL)		0.00%		0.00%
Covered payroll (active plan members)	$	5,937,061	$	5,678,422
UAAL as a percentage of covered payroll		58.82%		66.69%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trends. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The Schedule of Funding Progress, following the notes to the consolidated statutory financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the terms of the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

Significant methods and assumptions were unchanged for Fiscal Year 2012 and are as follows:

Significant Methods and Assumptions

	June 30, 2011	June 30, 2010
Actuarial valuation date	January 1, 2011	January 1, 2009
Actuarial cost method	Projected Unit Credit	Projected Unit Credit
Amortization method	Closed, level percentage of projected payroll amortization method	Closed, level percentage of projected payroll amortization method
Remaining amortization period	30 years	30 years
Asset valuation method	N/A - No Assets	N/A - No Assets
Actuarial assumptions:		
Investment rate of return	4.5%	4.5%
Projected salary increases	4.0%	4.5%
Health-care inflation rate	7.0% initial rate, 5% ultimate rate in 2083	7.0% initial rate, 5% ultimate rate in 2067
Inflation rate	3.5%	3.5%

In addition to the assumptions above, several factors also significantly contributed to the actuarial results. The PEBB voted to permanently eliminate the subsidy paid for life insurance premiums beginning in January 2012. Also in January 2012, explicit subsidies for retirees enrolled in Medicare Parts A and B were reduced from $183 per month to $150 per month. These changes caused the net liabilities to decrease.

Note 6 - Contingencies and Commitments

6.A. Contingencies

The Industrial Insurance Fund is party to numerous routine legal proceedings that normally occur in operations. At any given point, there may be numerous lawsuits that could impact expenses. There is a recurring volume of tort and other claims for compensation and damages against the Industrial Insurance Fund. The collective impact of these claims, however, is not likely to have a material impact on the Industrial Insurance Fund’s financial position, revenues, or expenses.

6.B. Commitments

Effective July 1, 1992, the Washington State Legislature required the Industrial Insurance Fund, under RCW 48.22.070, to participate in an assigned risk pool providing workers' compensation coverage under the United States Longshoreman and Harbor Workers' Act. The Industrial Insurance Fund is obligated to participate 50 percent in the underwriting losses or surpluses of the assigned risk pool. This participation is scheduled to continue indefinitely due to amending legislation passed in 1997; however, the Industrial Insurance Fund has not made any payments to this risk pool since enactment of this indefinite commitment.

6.C. Exposure

The lack of diversity of exposure by line of business and by state could be a risk factor for benefit liability and claims administration expense (CAE) reserves. By statute, the Fund's direct exposure is limited to one line of business (workers' compensation) in one state (Washington). Therefore, any adverse trends affecting this line of business and/or state could have a material effect on the Fund's benefit liability and CAE reserves. Such trends would include legislative benefit level changes that may have an effect on all open workers' compensation claims.

Note 7 – Leases

The Industrial Insurance Fund leases land, office facilities, office and computer equipment, and other assets under a variety of operating lease agreements. Although lease terms vary, most leases are subject to appropriation from the State Legislature to continue the obligation. Since the possibility of not receiving funding from the Legislature is remote, leases are considered non-cancelable for financial reporting purposes. Certain operating leases are renewable for specified periods. In most cases, management expects the leases to be renewed or replaced by other leases.

The total operating lease rental expenses for Fiscal Years 2012 and 2011 were $10,075,203 and $9,758,511, respectively. There are no contingent rental payments or unusual renewal options, escalation clauses or restrictions and there have been no early terminations of existing leases. Certain rental commitments have renewal options extending through the year 2022. Some of these renewals are subject to adjustments in future periods.

The following table presents future minimum payments for operating leases as of June 30, 2012:

Future Minimum Payments
June 30, 2012

Operating Leases (by Fiscal Year)	Accident Account	Medical Aid Account	Total
2013	$ 3,687,369	$ 3,396,201	$ 7,083,570
2014	3,630,180	3,335,032	6,965,212
2015	3,591,114	3,292,692	6,883,806
2016	3,525,639	3,214,232	6,739,871
2017	3,002,705	2,693,712	5,696,417
2018-2022	3,192,747	2,849,611	6,042,358
Total Future Minimum Lease Payments	$ 20,629,754	$ 18,781,480	$ 39,411,234

Note 8 - Sale, Transfer and Servicing of Financial Assets and Extinguishments of Liabilities

Securities Lending

Washington State law and the Washington State Investment Board (WSIB) policy permit the Industrial Insurance Fund to participate in securities lending programs to augment investment income. The WSIB has entered into an agreement with JPMorgan to act as agent for the WSIB in securities lending transactions. As JPMorgan is the custodian bank for the WSIB, it is counterparty to securities lending transactions.

Fixed income securities were loaned and collateralized by the Industrial Insurance Fund’s agent with cash, U.S. government securities (exclusive of mortgage-backed securities and letters of credit), and irrevocable letters of credit. When the loan securities had collateral denominated in the same currency, the collateral requirement was 102 percent of the fair value, including accrued interest, of the securities loaned. All other securities were required to be collateralized at 105 percent of the fair value, including accrued interest, of the loaned securities.

During Fiscal Years 2012 and 2011, securities lending transactions could be terminated on demand by either the Industrial Insurance Fund or the borrower. The weighted average maturity of loans for Fiscal Years 2012 and 2011 was 1.5 days. Cash collateral was invested by the Industrial Insurance Fund in the WSIB’s short-term investment pool. Since the securities lending agreements were terminable at will, the maturity dates of the liabilities for collateral to be returned did not generally match the investments made with the cash collateral. To provide liquidity to manage those discrepancies, JPMorgan is required to re-invest not less than 10 percent of the cash collateral received in overnight maturities to ensure sufficient liquidity available for the return of collateral to borrowers within the ordinary course of business. In the event loans are returned beyond what is expected in the ordinary course of business, JPMorgan would be allowed to sell investments to the extent that no losses would be incurred and would consult WSIB before selling any securities that would incur a loss.

Securities were loaned with the agreement that they would be returned in the future for exchange of the collateral. JPMorgan indemnified the Industrial Insurance Fund by agreeing to purchase replacement securities or credit the account an amount equal to the market value of the unreturned loaned securities in the event a borrower failed to return the loaned securities or pay distributions thereon. JPMorgan’s responsibilities included performing appropriate borrower and collateral investment credit analyses, demanding adequate types and levels of collateral, and complying with applicable federal regulations concerning securities lending.

During Fiscal Years 2012 and 2011, there were no significant violations of legal or contractual provisions, no failures by any borrowers to return loaned securities or to pay distributions thereon. Further, the Industrial Insurance Fund incurred no losses during Fiscal Years 2012 or 2011 resulting from a default by either the borrowers or the securities lending agents.

In accordance with reporting changes under SSAP No. 91R, the Industrial Insurance Fund reported securities lent (the underlying securities) as assets in the Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve, starting in Fiscal Year 2011. Cash received as collateral on securities lending transactions and investments made with that cash are reported as assets. Securities received as collateral are reported as assets if the Industrial Insurance Fund has the ability to pledge or sell them without a borrower default. Liabilities resulting from these transactions are also reported in the Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve. Securities lending transactions collateralized by securities that the Industrial Insurance Fund does not have the ability to pledge or sell unless the borrower defaults are not reported as assets and liabilities.

WSIB changed the custodian bank from JPMorgan to State Street, effective July 1, 2012, and all the securities on loan were recalled so they could be transferred. As a result, there were no collateral held or securities on loan at June 30, 2012. WSIB and State Street will resume securities lending activities in Fiscal Year 2013. At June 30, 2011, total collateral held and fair value of securities on loan were $2,445,538,583 and $2,384,653,255, respectively.

The market value of cash collateral assets at June 30, 2011, was $2,217,078,142, and the following table provides information regarding cash collateral assets:

Cash Collateral Held Under Securities Lending
June 30, 2011
(dollars in thousands)

				Maturity Date						
	NAIC Rating	Book Adjusted Carrying Value	Level 2 Fair Value	Under 30 days	30 - 59 days	60 - 89 days	90 - 119 days	120 - 179 days	180 days - less than 1 year	1 year - 2 years
Cash and cash equivalents	1	$ 1,162,772	$ 1,162,792	$ 593,379	$ 252,435	$ 20,034	$ 138,465	$ 14,024	$ 50,301	$ 94,154
Commercial paper	1	345,136	344,958	174,535	18,022	28,010	34,378	39,975	50,038	-
Bank and promissory notes	1	437,953	437,953	67,316	40,069	24,041	40,069	-	100,172	166,286
Repurchase agreements	1	113,008	113,008	32,870	-	-	80,138	-	-	-
Repurchase agreements	Not rated	36,062	36,062	36,062	-	-	-	-	-	-
Sovereign debt	1	40,069	40,069	-	-	-	-	20,034	20,035	-
Guaranteed insurance contracts	1	51,288	51,288	31,254	-	-	20,034	-	-	-
Miscellaneous	1	896	896	-	-	896	-	-	-	-
Miscellaneous	Not rated	30,052	30,052	-	-	-	-	-	-	30,052
Total Collateral Held		$ 2,217,236	$ 2,217,078	$ 935,416	$ 310,526	$ 72,981	$ 313,084	$ 74,033	$ 220,546	$ 290,492

Non-cash collateral cannot be pledged or sold absent borrower default. Accordingly, non-cash collateral held under securities lending contracts with a value of $228,460,441 at June 30, 2011, has not been included in the Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve. At June 30, 2012, there was no non-cash collateral held. Net earnings received through the securities lending program were $5,119,692 for Fiscal Year 2012 and $5,564,633 for Fiscal Year 2011.

Note 9 - Changes in Benefit and Claims Administration Liabilities

An increase of $614.3 million in the provision for insured events of prior years in benefit and claims administration liabilities in Fiscal Year 2012 is made up of $390.8 million of discount accretion, $81.4 million of change in the non-tabular discount rate, and $142.1 million of adverse development on prior years. The non-tabular discount rate was changed in December 2011 from

2.5 percent to 2.0 percent. For more information on discounting see Note 1.C.3. New liabilities for the current year decreased $24.9 million from the prior year mainly because of a decrease in claim frequency, offset by an increase in severity.

The following schedule presents the changes in benefit and claims administration liabilities for the fiscal years ended June 30, 2012 and 2011, for the Industrial Insurance Fund:

Changes in Benefit and Claim Administration Liabilities (dollars in thousands)				
		June 30, 2012		**June 30, 2011**
Unpaid benefit and claims administration liabilities, July 1	$	11,288,310	$	11,223,311
Incurred benefit and claims administration liabilities:				
Provision for insured events of the current year		1,524,878		1,549,771
Increase in provision for insured events of prior years		614,321		208,093
Total incurred benefit and claims administration liabilities		2,139,199		1,757,864
Payments:				
Benefit and claims administration liabilities attributable:				
To insured events of the current year		283,763		288,812
To insured events of prior years		1,404,816		1,404,053
Total payments		1,688,579		1,692,865
Total unpaid benefit and claims administration liabilities, June 30	$	11,738,930	$	11,288,310
Current portion	$	1,330,942	$	1,345,698
Long-term portion	$	10,407,988	$	9,942,612

At June 30, 2012 and 2011, $20.1 billion and $20.6 billion of unpaid benefit and claims administration liabilities are shown at their net present and settlement value of $11.7 billion and $11.3 billion, respectively. In the Accident Account, the incurred but not-yet-awarded pensions are discounted at a rate of 6.5 percent from the anticipated time of award, and 2.0 percent to the anticipated time of award from the present. All other Accident and Medical Aid Account benefits and claims administration liabilities are discounted at 2.0 percent. The benefit liabilities in the Pension Reserve Account are discounted at 6.5 percent.

Benefit Liability Development by Program June 30, 2012 (dollars in thousands)					
Program/ Category		**Undiscounted Liabilities**	**Discount Rate**		**Benefit Liabilities**
Accident	$	7,637,283	2.00% & 6.50%	$	4,245,695
Medical Aid		4,955,417	2.00%		3,458,833
Pensions		6,879,102	6.50%		3,498,427
Total Benefit Liability		19,471,802			11,202,955
Claim Administration Expense (CAE)		611,844	2.00%		535,975
Total Benefit and CAE Liabilities	$	20,083,646		$	11,738,930

Benefit Liability Development by Program June 30, 2011 (dollars in thousands)					
Program/ Category		**Undiscounted Liabilities**	**Discount Rate**		**Benefit Liabilities**
Accident	$	8,230,996	2.50% & 6.50%	$	4,139,876
Medical Aid		5,067,953	2.50%		3,265,484
Pensions		6,693,408	6.50%		3,387,688
Total Benefit Liability		19,992,357			10,793,048
Claim Administration Expense (CAE)		580,532	2.50%		495,262
Total Benefit and CAE Liabilities	$	20,572,889		$	11,288,310

Note 10 - Retrospectively-Rated Contracts and Contracts Subject to Redetermination

10.A. Method Used to Estimate

The Industrial Insurance Fund estimates accrued retrospective premium annual adjustments for unadjusted enrollment periods by reviewing historical participation and return patterns. The historical averages are used to arrive at an estimate of net retrospective return premiums for unadjusted periods. Cumulative return premiums for periods from first annual adjustment through third annual adjustment are system-generated, and the accruals are the difference between the cumulative returns and the amount already returned. The third annual retrospective adjustment is final.

10.B. Method Used to Record

Retrospective return premiums due to employers are netted with additional premiums due from employers and recorded as a liability.

10.C. Amount and Percent of Net Retrospective Premiums

Net premiums for the fiscal years ended June 30, 2012 and 2011, on retrospectively-rated workers' compensation policies were $690.1 million, or 42 percent, and $650.5 million, or 43 percent, of total workers' compensation net premiums, respectively.

10.D. Calculation of Nonadmitted Retrospective Premiums

Retrospective additional premiums 90 days past due after the third annual retrospective adjustment are nonadmitted.

Note 11 - Discounting of Liabilities for Unpaid Benefits or Unpaid Claims Administration Expenses

The case reserves shown in this exhibit are the reserves for pensions awarded through June 30, 2012, only. The State Fund estimates case reserves on certain other individual claims solely for the purpose of classification rating, retrospective rating, and experience rating. Such case reserves are not maintained on claims that do not enter the rating calculations, so they are not meaningful for claims less than approximately 18 months old or more than approximately seven years old.

11.A. Tabular Discounts

The mortality table is based upon 1980 census data. The liabilities are discounted at 6.5 percent per annum. The June 30, 2012, liabilities include $6,099,659,000 of such reserves, net of tabular discounts. The amount of the tabular discount for case reserves is $3,380,675,000 and $3,050,538,000 for Incurred But Not Reported (IBNR) reserves at June 30, 2012.

At June 30, 2011, the liabilities, net of tabular discounts, amounted to $5,955,865,000. The amount of the tabular discount for case reserves was $3,305,719,000 and $3,685,766,000 for IBNR reserves.

Liabilities Discounted on a Tabular Basis
June 30, 2012
(in thousands)

Fiscal Accident Year	Benefit Liabilities Gross of Tabular Discount	Tabular Discounts: Case	Tabular Discounts: IBNR	Benefit Liabilities Net of Tabular Discount
2002 & Prior	$ 5,274,736	$ 2,233,939	$ 261,201	$ 2,779,596
2003	597,345	201,376	114,255	281,714
2004	642,268	198,024	143,677	300,567
2005	669,732	175,308	182,181	312,243
2006	730,706	164,542	228,280	337,884
2007	848,312	154,469	301,742	392,101
2008	935,410	116,858	383,318	435,234
2009	848,641	64,435	388,990	395,216
2010	719,904	42,041	353,375	324,488
2011	670,233	21,358	352,473	296,402
2012	593,585	8,325	341,046	244,214
Total	$ 12,530,872	$ 3,380,675	$ 3,050,538	$ 6,099,659

11.B. Non-Tabular Discounts

The non-tabular discount rate is based upon the five-year average of the 20-year treasury yield rounded to the nearest one-half percent, less 2 percentage points. As of June 30, 2012, the rounded five-year average was 4.0 percent, and the indicated non-tabular discount rate was 2.0 percent. The non-tabular discount is calculated using the selected non-tabular discount rate and the anticipated payout of the liabilities. This discount rate was changed in December 2011 from 2.5 percent to 2.0 percent.

Excluding liabilities related to fiscal accident year 2012, the June 30, 2012, liabilities include $7,004,557,000 of discounted loss and loss adjustment expense liabilities discounted on a non-tabular basis at 2.0 percent. These discounted loss and loss adjustment expense liabilities would total $6,938,881,000 at the previous non-tabular discount rate of 2.5 percent. The reduction in the non-tabular discount rate increased the discounted liabilities at June 30, 2012, by $81,402,000.

The June 30, 2012, liabilities included $7,704,528,000 of reserves for benefits and $535,975,000 of reserves for claims administration expenses, net of tabular and non-tabular discounts. The amount of the non-tabular discounts for IBNR reserves was $1,837,634,000; the reserve for defense and cost containment expense was $46,515,000; and the reserve for adjusting and other expense was $29,354,000.

At June 30, 2011, the liabilities included $7,405,360,000 of reserves for benefits and $495,262,000 of reserves for claims administration expenses, net of tabular and non-tabular discounts. The amount of the non-tabular discounts for IBNR reserves was $2,207,821,000; the reserve for defense and cost containment expense was $54,764,000; and the reserve for adjusting and other expense was $30,506,000.

Liabilities Discounted on a Non-Tabular Basis
June 30, 2012
(in thousands)

Fiscal Accident Year	Benefit & CAE Liabilities Net of Tabular and Gross of Non-Tabular Discount	Non-Tabular Discounts: Case	IBNR	DCC	AO	Benefit & CAE Liabilities Net of Tabular and Non-Tabular Discount
2002 & Prior	$ 2,250,373	$ -	$ 579,839	$ 11,899	$ 2,274	$ 1,656,361
2003	295,253	-	61,258	1,389	712	231,894
2004	358,599	-	70,575	1,644	958	285,422
2005	442,768	-	80,848	1,957	1,331	358,632
2006	552,004	-	96,863	2,407	1,761	450,973
2007	704,922	-	116,222	2,986	2,436	583,278
2008	896,578	-	138,541	3,696	3,322	751,019
2009	975,967	-	150,014	4,048	3,619	818,286
2010	1,063,480	-	170,094	4,682	3,684	885,020
2011	1,166,692	-	173,641	5,165	4,214	983,672
2012	1,447,370	-	199,739	6,642	5,043	1,235,946
Total	$ 10,154,006	$ -	$ 1,837,634	$ 46,515	$ 29,354	$ 8,240,503

Note 12 - Related Party Transactions

The Industrial Insurance Fund transfers expenditures and cash within the Accident, Medical Aid, and Pension Reserve accounts, as well as the Supplemental Pension and Second Injury accounts from the Workers' Compensation Program.

Certain goods and services are provided to Labor & Industries by other Washington State agencies. The Washington State Treasurer's Office and the Washington State Investment Board are the Industrial Insurance Fund's agents for managing its cash and investments. Fees related to the management of the Industrial Insurance Fund's investments are deducted from investment income.

The tables below summarize payments made and expenditures reported for services provided by other Washington State agencies for Fiscal Years 2012 and 2011. Payments made may be more or less than reported expenditures due to accruals.

Related Party Transactions
Payments Made

	Fiscal Year 2012	Fiscal Year 2011
Consolidated Technology Services	$ 5,242,693	$ -
Department of Corrections	3,146	-
Department of Enterprise Services	7,237,237	-
Department of Information Services	3,578,484	11,429,384
Department of General Administration	1,452,725	7,552,374
Department of Licensing	4,870	-
Department of Personnel	1,297,385	1,539,111
Department of Printing	110,679	809,651
Department of Transportation	14,498	-
Employment Security Department	48,116	-
Office of Administrator for the Courts	8,094	-
Office of Administrative Hearings	101,738	-
Office of Financial Management	1,299,237	603,206
Office of the Attorney General	14,815,648	18,082,680
Office of the State Auditor	444,367	540,933
Office of the State Treasurer	1,088	-
Office of the Secretary of State	335,380	336,525
Washington State Patrol	385,067	557,315
Total	$ 36,380,452	$ 41,451,179

Related Party Transactions
Expenditures Reported

	Fiscal Year 2012	Fiscal Year 2011
Consolidated Technology Services	$ 6,800,790	$ -
Department of Corrections	3,677	-
Department of Enterprise Services	8,996,727	-
Department of Information Services	3,578,484	12,004,212
Department of General Administration	1,452,725	7,235,904
Department of Licensing	7,386	-
Department of Personnel	1,297,385	1,618,293
Department of Printing	110,679	807,933
Department of Revenue	1,074	-
Department of Transportation	14,749	-
Employment Security Department	56,475	-
Office of the Administrator for the Courts	8,597	-
Office of Administrative Hearings	155,538	-
Office of Financial Management	1,332,706	573,406
Office of the Attorney General	17,837,938	18,103,264
Office of the State Auditor	457,429	583,573
Office of the State Treasurer	1,276	-
Office of the Secretary of State	351,866	356,541
Washington State Patrol	481,257	554,585
Total	$ 42,946,758	$ 41,837,711

The following amounts were due to other Washington State agencies at the end of the fiscal year:

Amounts Due to Related Parties for Goods and Services	June 30, 2012	June 30, 2011
Consolidated Technology Services	$ 1,558,097	$ -
Department of Corrections	18,662	-
Department of Enterprise Services	2,252,080	121,019
Department of Information Services	-	1,675,479
Department of General Administration	-	370,601
Department of Licensing	104	-
Department of Personnel	-	193,862
Department of Revenue	1,074	-
Department of Transportation	2,458	-
Employment Security Department	75,523	
Office of Administrator for the Courts	504	-
Office of Administrative Hearings	53,800	-
Office of Financial Management	33,469	9,318
Office of the Attorney General	3,022,290	1,536,846
Office of the State Auditor	13,062	74,765
Office of the State Treasurer	377	-
Office of the Secretary of State	30,378	49,050
Washington State Patrol	96,700	89,460
Total	$ 7,158,578	$ 4,120,400

The following amounts were due from other Washington State agencies at the end of the fiscal year:

Amounts Due from Related Parties for Goods and Services	June 30, 2012	June 30, 2011
Office of the Attorney General	$ 14,591	$ -
Department of Enterprise Services	5,457	-
Department of Personnel	-	7
Washington State Patrol	-	4,225
Total	$ 20,048	$ 4,232

The Washington State Legislature and the Governor provide appropriation authority from the Industrial Insurance Fund for the use by the following Washington State agencies:

- **Board of Industrial Insurance Appeals** hears appeals of decisions made by the Department of Labor & Industries.
- **Health Care Authority** assists with reviews to develop preferred prescription drug lists.
- **Department of Health** completes surveys and on-site investigations of farm worker housing.

- **University of Washington** aims to promote health and minimize occupational disease or injury through teaching, research, and service.

The operating expenses incurred by these agencies are summarized in the following table and are included in the Industrial Insurance Fund's financial information report totals.

Related Party Operating Expenses for Fiscal Years				
		2012		2011
Board of Industrial Insurance Appeals	$	17,334,549	$	17,053,918
Health Care Authority		268,727		221,982
Department of Health		174,370		189,157
University of Washington		6,047,145		6,744,019
Total	$	23,824,791	$	24,209,076

Note 13 - Income Taxes

The Industrial Insurance Fund is exempt from federal income tax under the Internal Revenue Service Code sections 115 and 501(c) (27).

Note 14 - Capital and Contingency Reserve

14.A. Capital

The Industrial Insurance Fund has no shares of stock authorized or outstanding.

14.B. Contingency Reserve

The contingency reserve represents net admitted assets available for financing ongoing operations and uncertainties not otherwise reserved. Changes in the contingency reserve are made up of investment and insurance operating results.

For Fiscal Years 2012 and 2011, changes in the contingency reserve resulted from the following:

Explanation of Fiscal Years 2012 and 2011 State Fund Results
(in millions)

	Fiscal Year 2012	Fiscal Year 2011
Contingency Reserve, July 1	$ 779	$ 181
Unexpected Investment Results:		
Actual Unrealized and Realized Gains (Losses):		
Equities: Unrealized gains (losses)	(583)	371
TIPS: Unrealized gains	36	46
Equities: Realized gains	516	23
Fixed Income: Realized gains	32	46
Total Actual Unrealized and Realized Gains	1	486
Less Expected Gains	(110)	(106)
Total Unexpected Investment Results	(109)	380
Insurance Operation Results:		
Prior year loss favorable (unfavorable)	(35)	175
Reduction of non-pension discount rate	(81)	-
Prior year retro (unfavorable)	(54)	-
Premium adequacy	80	43
Total Insurance Operating Results	(90)	218
Change to contingency reserve	(199)	598
Contingency Reserve, June 30	$ 580	$ 779

The contingency reserve balances by fund for Fiscal Years 2012 and 2011 were:

Contingency Reserve Balances by Fund

	Accident Account	Medical Aid Account	Pension Reserve Account	Total
Contingency Reserve, June 30, 2012	$ 34,599,000	$ 545,771,000	$ -	$ 580,370,000
Contingency Reserve, June 30, 2011	$ 63,250,000	$ 716,119,000	$ -	$ 779,369,000

Note 15 - Asbestos and Environmental Reserves

Claims related to asbestos and hazardous chemicals or waste arise mainly as a result of the claimants' exposure at work and are covered by the Industrial Insurance Fund. There is not a large exposure, and it is not fundamentally different from any other injury due to exposure to hazardous materials in normal industrial activity. Case and IBNR (Incurred But Not Reported) reserves related to asbestos or environmental exposure claims are not specially reserved. IBNR and CAE (claims administration expense) reserves related to asbestos claims are included as part of benefit and CAE liabilities.

The table below shows a gross basis for the case reserves related to asbestos. Labor & Industries does not currently hold any reinsurance agreements.

Workers' Compensation
Asbestos Claims for Fiscal Years

	2012	2011	2010
Beginning case reserve related to asbestos	$ 49,973,965	$ 51,098,510	$ 53,441,284
Benefits incurred	5,788,998	8,812,306	6,688,454
Payments made	(6,464,923)	(9,936,851)	(9,031,228)
Ending case reserve related to asbestos	$ 49,298,040	$ 49,973,965	$ 51,098,510

Note: Amounts are case reserves and do not include IBNR or CAE reserves.

Note 16 - Subsequent Events

For the annual Statutory Financial Information Report as of June 30, 2012, an analysis of subsequent events has been evaluated through the report issue date of December 31, 2012. The event described below existed after June 30, 2012.

16.A. Proposed Rate Announcement

Each year, the Director of the Department of Labor & Industries adopts new workers' compensation insurance premium rates for the next calendar year. On September 17, 2012, the Director announced a proposed "no increase" in the average premium rate for 2013. The final rates will be adopted in early December 2012 and go into effect on January 1, 2013.

Washington State Department of
Labor & Industries

Keep Washington Safe and Working

Supplementary Information

State of Washington Workers' Compensation Fund - Basic Plan
Schedule of Claims Development Information
Fiscal Years 2003 through 2012
(in millions)

The table below illustrates how the Workers’ Compensation Fund Basic Plan’s earned revenues (net of reinsurance) and investment income compare to the related costs of losses (net of loss assumed by reinsurers) and other expenses assumed by the Program as of the end of each of the last ten fiscal years. The Workers’ Compensation Fund has not purchased reinsurance since September 30, 2002, and has never had a qualifying event that generated a recovery.

The rows of the table are defined as follows:

1. This line shows each fiscal year's earned contribution revenues and investment revenues.
2. This line shows the Basic Plan's incurred claims (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred (called fiscal accident year).
3. This section shows the cumulative amounts paid as of the end of successive years for each fiscal accident year.
4. This section shows how each fiscal accident year's incurred claims increased or decreased as of the end of successive years. Annual re-estimation results from new information received on known claims, re-evaluation of existing information on known claims, and emergence of new claims not previously known.
5. This line compares the latest re-estimated incurred claims amount to the amount originally established (line 2) and shows whether this latest estimate of claims cost is greater or less than originally thought. As data for individual fiscal accident years mature, the correlation between original estimates and re-estimates is commonly used to evaluate the accuracy of incurred claims currently recognized in less mature fiscal accident years.

The columns of the table show data for successive fiscal years.

		2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
1.	Net earned required contribution and investment revenues	$ 2,111	$ 1,337	$ 2,452	$ 1,392	$ 2,406	$ 1,697	$ 1,692	$ 2,797	$ 2,525	$ 2,581
2.	Estimated incurred claims and expenses, end of fiscal accident year	2,284	2,505	2,308	2,141	2,196	2,256	2,363	2,312	2,254	2,086
3.	Paid (cumulative) as of:										
	End of fiscal accident year	233	244	260	278	295	310	322	298	289	284
	One year later	501	528	556	589	625	679	667	604	584	
	Two years later	650	681	715	754	817	890	863	773		
	Three years later	751	784	821	873	953	1,042	1,000			
	Four years later	824	860	906	964	1,059	1,162				
	Five years later	882	925	977	1,038	1,144					
	Six years later	934	982	1,039	1,103						
	Seven years later	982	1,031	1,094							
	Eight years later	1,027	1,076								
	Nine years later	1,066									
4.	Re-estimated incurred claims and expenses:										
	End of fiscal accident year	2,284	2,505	2,308	2,141	2,196	2,256	2,363	2,312	2,254	2,086
	One year later	2,277	2,203	1,989	2,053	2,234	2,559	2,535	2,271	2,139	
	Two years later	2,045	1,971	1,939	2,055	2,390	2,647	2,538	2,261		
	Three years later	1,853	1,864	1,954	2,151	2,441	2,724	2,485			
	Four years later	1,767	1,886	2,025	2,196	2,526	2,662				
	Five years later	1,788	1,941	2,067	2,244	2,445					
	Six years later	1,829	1,966	2,111	2,198						
	Seven years later	1,868	2,016	2,056							
	Eight years later	1,907	1,965								
	Nine years later	1,873									
5.	Increase (decrease) in estimated incurred claims and expenses from end of fiscal accident year	(411)	(540)	(252)	57	249	406	122	(51)	(115)	

Source: Washington State Department of Labor & Industries Actuarial Services

State of Washington Schedule of Funding Progress for Other Postemployment Benefits

This schedule presents the results of the OPEB valuation for Valuation Years 2011, 2009, and 2008:

Schedule of Funding Progress
Other Postemployment Benefits
Valuation Years 2011, 2009, and 2008
(dollars in millions)

	2011	2009	2008
Actuarial valuation date	1/1/2011	1/1/2009	1/1/2008
Actuarial value of plan assets	$ -	$ -	$ -
Actuarial accrued liability (AAL)*	3,492	3,787	4,014
Unfunded actuarial accrued liability (UAAL)	3,492	3,787	4,014
Funded ratio	0.00%	0.00%	0.00%
Covered payroll	5,937	5,678	5,170
UAAL as a percentage of covered payroll	58.82%	66.69%	77.64%

* Based on projected unit credit actuarial cost method.

Source: Washington State Office of the State Actuary

Source: Washington State Office of Financial Management

Note: No valuation was made by the State Actuary in Calendar Year 2010.

Supplemental Investment Risk Interrogatories
June 30, 2012

1. The Industrial Insurance Fund's total admitted assets as reported on page 23 of this annual Statutory Financial Information Report were $12,511,786,000 at June 30, 2012.

2. Following are the Industrial Insurance Fund's ten largest exposures to a single issuer/borrower/investment by investment category, excluding (i) U.S. government, U.S. government agency securities, and those U.S. government money market funds listed in the Appendix to the SVO's *Practices and Procedures Manual* as exempt, (ii) property occupied by the Industrial Insurance Fund, and (iii) policy loans:

	Amount	Percentage of Total Admitted Assets
Bond - British Columbia Prov Of	$ 119,971,000	0.96%
Bond - Norfolk Southern Corp	105,409,000	0.84%
Bond - Burlington Northern	100,328,000	0.80%
Bond - Intl Finance Corp	99,747,000	0.80%
Bond - Citigroup Commercial Mortgage	89,712,000	0.72%
Bond - Vale Overseas Limited	88,812,000	0.71%
Bond - Duke Energy Corp	84,871,000	0.68%
Bond - Southern Cal Edison	81,839,000	0.65%
Bond - Petrobras Intl Fin Co	80,397,000	0.64%
Bond - Arcelormittal	69,820,000	0.56%

3. The Industrial Insurance Fund's total admitted assets held in bonds and preferred stocks, by NAIC rating, including bonds classified as short-term investments at June 30, 2012, were:

	Amount	Percentage of Total Admitted Assets
Bonds with an NAIC rating of 1	$ 7,100,359,000	56.75%
Bonds with an NAIC rating of 2	2,831,365,000	22.63%
Bonds with an NAIC rating of 3	313,990,000	2.51%
Bonds with an NAIC rating of 4	-	0.00%
Bonds with an NAIC rating of 5	-	0.00%
Bonds with an NAIC rating of 6	-	0.00%

4. Assets held in foreign investments:

   Assets held in foreign investments exceeded 2.5 percent of the Industrial Insurance Fund's total admitted assets.

Supplemental Investment Risk Interrogatories
June 30, 2012

Total admitted assets held in foreign investments at June 30, 2012:

Asset Type	Amount	Percentage of Admitted Assets
Bonds	$ 3,276,132,000	26.18%
Equities	$ 628,820,000	5.03%

Total admitted assets held in foreign investments in bonds by NAIC rating at June 30, 2012:

NAIC Rating	Amount	Percentage of Admitted Assets
Countries rated NAIC – 1	$ 1,473,306,000	11.78%
Countries rated NAIC – 2	$ 1,570,325,000	12.55%
Countries rated NAIC – 3	$ 232,501,000	1.86%

Ten largest non-sovereign (i.e. non-governmental) investments held in foreign issues at June 30, 2012:

Issuer	NAIC Rating	Amount	Percentage of Admitted Assets
British Columbia Prov of	1	$ 119,971,000	0.96%
Intl Finance Corp	1	99,747,000	0.80%
Vale Overseas Limited	2	88,812,000	0.71%
Petrobras Intl Finance Co.	2	80,397,000	0.64%
Arcelormittal	2	69,820,000	0.56%
Canadian Natl Resources	2	69,792,000	0.56%
Hutchison Whampoa Intl	1	69,763,000	0.56%
Siemens Financieringsmat	1	59,907,000	0.48%
Eksportfinans A/S	3	59,064,000	0.47%
Talisman Energy Inc	2	57,552,000	0.46%

	Amount	Percentage of Admitted Assets
5. Total admitted assets held in Canadian investments	$1,023,423,000	8.18%

6. The Industrial Insurance Fund had no investments with contractual sales restrictions, which are defined as investments having restrictions that prevent them from being sold within 90 days.

Supplemental Investment Risk Interrogatories
June 30, 2012

7. The Industrial Insurance Fund's admitted assets held in equity interests (including investments in the shares of mutual funds, preferred stocks, publicly traded equity securities, and other equity securities (including Schedule BA equity interests) and excluding money market and bond mutual funds listed in the Appendix to the SVO's *Practices and Procedures Manual* as exempt, or Class 1) were:

Fund		Amount	Percentage of Admitted Assets
BTC US IMI Fund B2	$	951,064,000	7.60%
MSCI EAFE Index SL CTF		377,209,000	3.01%
MSCI Emerging Markets Free		131,757,000	1.05%
MSCI Small Cap Index (EAFE)		50,403,000	0.40%
Canada MSCI CTF		44,881,000	0.36%
MSCI Emerging Markets Small		17,101,000	0.14%
MSCI CDA Small Cap IDX SL		7,468,000	0.06%
WSIB 550715 US EQ		332,000	0.00%

8. The Industrial Insurance Fund did not hold any non-affiliated, privately placed equities under Securities Exchange Commission (SEC) Rule 144a or SEC Rule 144 without volume restrictions.

9. The Industrial Insurance Fund did not hold general partnership interests.

10. The Industrial Insurance Fund did not own any mortgage loans.

11. The Industrial Insurance Fund did not have any individual parcels or groups of contiguous parcels of real estate.

12. The Industrial Insurance Fund held no investments in mezzanine real estate loans.

13. The Industrial Insurance Fund did not have admitted assets subject to repurchase agreements, reverse repurchase agreements, dollar repurchase agreements or dollar reverse repurchase agreements at June 30, 2012.

14. The Industrial Insurance Fund did not own any warrants not attached to other financial instruments, options, caps, and floors at June 30, 2012.

15. The Industrial Insurance Fund did not have any exposure for collars, swaps, and forwards during Fiscal Year 2012.

16. The Industrial Insurance Fund did not have any potential exposure for futures contracts during Fiscal Year 2012.

Summary Investment Schedule
June 30, 2012

The Industrial Insurance Fund held cash and invested assets as of June 30, 2012, consisting of the following:

	Gross Investment Holding		Admitted Assets as Reported in the Annual Report	
	Amount	Percentage	Amount	Percentage
Bonds:				
U.S. Treasury securities	$ 2,361,181,000	19.64%	$ 2,361,181,000	19.64%
Foreign government (including Canada, excluding mortgage-backed securities)	89,670,000	0.75%	89,670,000.00	0.75%
Mortgage-backed securities (includes residential and commercial mortgage-backed securities)				
Issued or guaranteed by GNMA	95,990,000	0.80%	95,990,000	0.80%
Issued or guaranteed by FNMA, FHLMC	442,564,000	3.68%	442,564,000	3.68%
Issued or guaranteed by all other	1,353,321,000	11.25%	1,353,321,000	11.25%
Other fixed income securities (excluding short-term)				
Unaffiliated domestic securities	2,716,527,000	22.59%	2,716,527,000	22.59%
Unaffiliated foreign securities	3,186,462,000	26.50%	3,186,462,000	26.50%
Equity interests:				
Commingled index funds - domestic	951,396,000	7.91%	951,396,000	7.91%
Commingled index funds - foreign	628,820,000	5.23%	628,820,000	5.23%
Receivables for securities and interest	109,624,000	0.91%	109,624,000	0.91%
Cash and cash equivalents	6,970,000	0.06%	6,970,000	0.06%
Short-term investments	82,211,000	0.68%	82,211,000	0.68%
Total	$ 12,024,736,000	100.00%	$ 12,024,736,000	100.00%

Washington State Department of
Labor & Industries

Keep Washington Safe and Working

Independent Actuarial Opinion

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October 5, 2012

Statement of Actuarial Opinion

State of Washington – Industrial Insurance Fund

Identification

I, Rod Morris, am a Specialist Leader with the firm of Deloitte Consulting LLP. I am a Member of the American Academy of Actuaries and meet its qualification standards for rendering this Statement of Actuarial Opinion, and I am a Fellow of the Casualty Actuarial Society. I was appointed by the Washington State Auditors' Office to provide a Statement of Actuarial Opinion regarding the reasonableness of the State of Washington Industrial Insurance Fund's ("the Fund") carried loss and loss adjustment expense ("LAE") reserves as of June 30, 2012.

The Fund is comprised of three Workers' Compensation Program Accounts: the Accident Account, the Medical Aid Account, and the Pension Reserve Account. The Fund is currently administered by the State of Washington Department of Labor & Industries ("the Department").

Scope

I have examined the reserves listed in Exhibit A: Scope, as shown in the Fund's Statutory Financial Information Report, as of June 30, 2012. The loss and loss adjustment expense reserves specified in Exhibit A, on which I am expressing an opinion, reflect the Loss Reserve Disclosure items (8 thru 10) listed in Exhibit B.

In forming my opinion on the loss and loss adjustment expense reserves, I relied upon data provided by Mr. William Vasek, the Department's Chief Actuary, his actuarial staff, and Sharon Elias, the Department's Financial Services Program Manager. I evaluated that data for reasonableness and consistency. My examination included the use of such actuarial assumptions and methods and such tests of the calculations as I considered necessary.

My review was limited to items listed in Exhibit A, and did not include an analysis of any other balance sheet items. I have not examined the Fund's assets and I have formed no opinion as to the validity or value of these assets. My opinion on the loss and loss adjustment expense reserves is based upon the assumption that all reserves are backed by valid assets, which have suitably scheduled maturities and/or adequate liquidity to meet the cash flow requirements of the liabilities.

Opinion

In my opinion, the amounts carried in Exhibit A on account of the items identified:

(A) meet the requirements of the insurance laws of the State of Washington.

(B) are consistent with reserves computed in accordance with accepted loss reserving standards and principles.

(C) make a reasonable provision for all unpaid loss and loss expense obligations of the Fund under the terms of its contracts and agreements.

Relevant Comments

A. Risk of Material Adverse Deviation

I have identified the major risk factors for the Fund as the lack of diversity of exposure by line of business and by state, future medical trend, the discounting of the reserves, reserve leverage, future cost of living adjustments and the impact of the 2011 Reforms. The potential impact of these risk factors is described in the following paragraphs. The absence of other risk factors from this listing does not imply that additional factors will not be identified in the future as having been a significant influence on the Fund's reserves.

By statute, the Fund's direct exposure is limited to one line of business (workers' compensation) in one state (Washington). Therefore, any adverse trends affecting this line of business and/or state could have a material effect on the Fund's loss and loss adjustment expense reserves. Such trends would include legislative benefit level changes that may have an effect on all open workers' compensation claims.

A major assumption in the analysis of the medical component of the workers' compensation reserves is the selection of a long-term medical trend factor to apply to future calendar year medical payments. Estimating medical trend has become increasingly difficult in recent years because it has been highly variable. In my opinion, there is a higher than normal degree of variability associated with the Fund's medical loss reserves due to the uncertainty surrounding future medical trends and the expected length of medical payments.

The Department discounts the loss and loss adjustment expense reserves to reflect the time value of money using an average annual interest rate of 3.98%. Changes to the interest rate used for discounting could result in material changes to the reserves.

The Fund defines its "Contingency Reserve" as the difference between its assets and liabilities. Other insurance companies typically refer to this Contingency Reserve as Statutory Surplus. Due to the size of the Fund's Contingency Reserve, $580.4 million, relative to the size of its loss and loss adjustment expense reserve, $11.7 billion, any small changes in reserves will have a material impact on the Contingency Reserve. The current reserve leverage ratio (reserve / contingency reserve) is significantly higher than the majority of workers' compensation carriers in the industry and workers' compensation funds in other states.

An implicit assumption in the Department's actuarial review is that the State of Washington cost of living adjustments will be similar to cost of living adjustments approved by the Federal Government for Social Security retirement benefits. Future State of Washington cost of living adjustments that vary significantly from those approved by the Federal Government for Social Security retirement benefits could result in a material change in future costs and the adequacy of the reserves, especially for the Pension Reserve Account.

During 2011, the State of Washington passed two bills (SSB 5801 and EHB 2123) that promote getting workers back on the job faster and made other changes that impact costs. These changes are expected to reduce the system's overall costs in the future and also have an impact on past claims. These reforms are considered in the Department's unpaid claim liability as of June 30, 2012. Key changes included in the reforms are:

- Claim Resolution Structured Settlement Agreements
- Deductions for Prior PPD Awards from TPD Benefits
- Elimination of Interest on Unpaid PPD Award Schedules
- One-Year Freeze in COLA, Delay in First COLAs
- Washington Stay-At-Work Program
- Statewide Provider Network
- COHE Expansion

There is uncertainty related to the impact of these changes on the unpaid claim liability. The amount of savings contemplated in the unpaid claim liability as of June 30, 2012 totals $457.3 million on a discounted basis.

With respect to this Statement of Actuarial Opinion, the amount of adverse deviation that I consider to be material is $116.1 million. My basis for determining this amount is 20% of the Contingency Reserve, which is an amount that would represent a reasonable upward fluctuation in loss and loss adjustment expense reserves from those carried by the Fund that would be material to the Contingency Reserve. At this time, my assessment is that the Fund does have a significant risk of a material adverse deviation.

My materiality standard was selected based on the context in which this opinion letter will be used. It is prepared solely to assess the reasonableness of the Fund's loss and loss adjustment expense reserves. Other measures of materiality might be used for reserves that are being evaluated in a different context.

B. Other Disclosures in Exhibit B

Underwriting Pools or Associations

The Fund participates in the Washington United States Longshore and Harbor Workers' Compensation Act Assigned Risk Plan ("WARP") which was established to provide USL&H workers' compensation insurance coverage for employers unable to purchase it through the normal private insurance market. The Fund pays assessments to WARP and participates in any underwriting losses or surpluses incurred by WARP. Based on discussions with the Department, we understand that WARP is not currently in a deficit position. Therefore, the Fund has not booked a reserve to account for any unpaid claim liability related to WARP.

We understand that the Fund does not participate in any other voluntary or involuntary pools.

Asbestos Exposures and Environmental Exposures

I have reviewed the Fund's exposure to asbestos and environmental claims. In my opinion, the chance of material liability related to asbestos and environmental claims is remote. The Fund has not provided coverage that could reasonably be expected to produce material levels of asbestos and/or environmental liability claims activity.

Disclosure of Unearned Premium Reserves for Long Duration Contracts

The Fund does not write single or fixed premium policies with coverage periods of thirteen months or greater which are non-cancelable and not subject to premium increase.

Reinsurance

The Fund has no ceded or assumed reinsurance. Based on discussions with the Department's management and their description of the Fund's ceded (and/or assumed) reinsurance, I am not aware of any reinsurance contract that either has been or should have been accounted for as retroactive reinsurance or financial reinsurance.

Discounting

The Department discounts the loss and loss adjustment expense reserves to reflect the time value of money. The amount of discount is based on an actuarially derived projected payment pattern and two selected annual interest rates.

- For the Medical Aid Account, the Fund's chosen interest rate is 2.0%.
- For the Pension Reserve Account, the chosen interest rate is 6.5%.
- For the Accident Account, a combination of the two interest rates is used to discount the reserves. The future permanent total disability and fatal transfers made to the Pension Account are discounted assuming an interest rate of 6.5%. All other payments are discounted using a rate of 2.0%.

The average combined interest rate for the Fund is approximately 3.98% with a total discount amount of $8.3 billion. The interest rates were selected by the Department, and I make no opinion regarding the appropriateness of the selected rates. The interest rate used to discount the

Accident Account future permanent total disability and fatal transfers made to the Pension Account remained the same this year at 6.5%. The interest rate used for all other future payments was reduced this year from 2.5% to 2.0%. The effect of reducing this interest rate was an increase in the discounted unpaid claim liability of $334.2 million.

Major Assumption Changes

The Department lowered its long term inflation rate assumption this year from 2.5% to 2.0% to reflect more recent lower inflation rates. The effect of reducing the inflation rate was a decrease in the discounted unpaid claim liability of $252.8 million.

C. General Uncertainty

In evaluating whether the reserves make a reasonable provision for unpaid losses and loss adjustment expense, it is necessary to project future loss and loss adjustment expense payments. It is certain that actual future losses and loss adjustment expenses will not develop exactly as projected and may, in fact, vary significantly from the projections. No warranty is expressed or implied that such variance will not occur.

Further, my projections make no provision for the broadening of coverage by legislative action or judicial interpretation or for extraordinary future emergence of new classes of losses or types of losses not sufficiently represented in the Fund's historical data base or which are not yet quantifiable.

Actuarial Report

An actuarial report and underlying actuarial workpapers supporting the findings expressed in this Statement of Actuarial Opinion will be provided to the Department to be retained for a period of seven years in its administrative offices and available for regulatory examination.

This Statement of Opinion is solely for the use of assessing the reasonableness of the loss and LAE reserves and is only to be relied upon by the Fund and the State.

Rod Morris

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October 5, 2012

Statement of Actuarial Opinion – Year Ended June 30, 2012

State of Washington Industrial Insurance Fund

Exhibit A: SCOPE

Loss Reserves:	**Amount**
A. Net of Reinsurance Reserve for Unpaid Losses	$11,202,955,000
B. Net of Reinsurance Reserve for Unpaid Loss Adjustment Expenses **Total Net Loss and Loss Adjustment Expenses Reserves**	$ 535,975,000 $11,738,930,000
C. Reserve of Unpaid Losses – Direct and Assumed	$11,202,955,000
D. Reserve for Unpaid Loss Adjustment Expenses – Direct and Assumed **Total Gross Loss and Loss Adjustment Expense Reserves**	$ 535,975,000 $11,738,930,000
E. Retroactive Reinsurance Reserve Assumed	$0
F. Other Loss Reserve items on which the Appointed Actuary is expressing an Opinion	$0
Premium Reserves:	
G. Reserve for Direct and Assumed Unearned Premiums for Long Duration Contracts	$0
H. Reserve for Net Unearned Premiums for Long Duration Contracts	$0
I. Other Premium Reserve items on which the Appointed Actuary is expressing an Opinion	$0

Statement of Actuarial Opinion – Year Ended June 30, 2012

State of Washington Industrial Insurance Fund

Exhibit B: DISCLOSURES

Item:	**Column 1**	**Column 2**	**Column 3**	**Column 4**
1. **Name of Appointed Actuary**		**Last** Morris	**First** Rodney	**Middle** Scott
2. **The Appointed Actuary's Relationship to the Company.** Enter E or C based upon the following: E if an Employee, C if a Consultant			**C**	
3. **The Appointed Actuary is a Qualified Actuary based upon what qualification?** Enter F, A, M, or O based upon the following: **F** if a Fellow of the Casualty Actuarial Society (FCAS) **A** if an Associate of the Casualty Actuarial Society (ACAS) **M** if not a member of the Casualty Actuarial Society, but a Member of the American Academy of Actuaries approved by the Casualty Practice Council, as documented with the attached approval letter. **O** for Other			**F**	
4. **Type of Opinion, as identified in the OPINION** paragraph. Enter R, I, E, Q, or N based upon the following: **R** if reasonable **I** if Inadequate or Deficient Provision **E** if Excessive or Redundant Provision **Q** if Qualified. Use Q when part of the OPINION is Qualified. **N** if No Opinion			**R**	
5. **Materiality Standard expressed in $US** (Used to answer Question #6.)	$116,074,000			
6. Is there a Significant Risk of Material Adverse Deviation? YES or NO				YES [X] NO [ ]
7. **Statutory Surplus (Contingency Reserve)**	$580,370,000			

State of Washington Industrial Insurance Fund

Exhibit B: DISCLOSURES

Item:	**Column 1**	**Column 2**	**Column 3**	**Column 4**
8. Discount included as a reduction to loss reserves and loss expense reserves as reported in Schedule P				
8.1 Non-tabular Discount	$1,913,503,000			
8.2 Tabular Discount	$6,431,213,000			
9. The net reserves for losses and expenses for the Company's share of voluntary and involuntary underwriting pools' and associations' unpaid losses and expenses that are included in reserves shown on the Liabilities, Surplus and Other Funds page, Losses and Loss Adjustment Expenses lines.	n/a			
9. The total claims made extended loss and expense reserve (Schedule P Interrogatories)				
9.1 Amount reported as loss reserves	n/a			
9.2 Amount reported as unearned premium reserves	n/a			
10. Other items on which the Appointed Actuary is providing Relevant Comments	n/a			

State of Washington Industrial Insurance Fund
Statutory Financial Information Report

Other formats for persons with disabilities are available on request.
Call 1-800-547-8367. TDD users, call 360-902-5797.
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